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CASE NO.:

In The
SUPREME COURT OF THE UNITED STATES

October Term, 1991

The People of the State of Illinois
ex rel. The Office of Public Cousnel et al.

Petitioners,

v.

The Illinois Commerce Commission et al.

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE ILLINOIS SUPREME COURT

PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED FOR REVIEW

Whether the Illinois Supreme Court correctly held that the Illinois Commerce Commission is preempted by the Sixth Amendment's Supremacy Clause and the Natural Gas Act's filed rate doctrine from allocating take-or-pay gas costs between local segments of the gas industry even after the Federal Energy Regulatory Commission determined that states were to implement its allocation policy pursuant to the Natural Gas Act. United States Constitution, U.S. Const., Art. VI, cl. 2; Natural Gas Act, 15 U.S.C., sect. 717 _et seq_. (1988).

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The opinion of the Illinois Supreme Court is reported at 143 Ill.2d 407 (1991), and is included in the Appendix to this Petition at A1. The opinion of the Illinois Appellate Court, Fourth District is reported at 191 Ill. App. 3d 450, 547 N.E.2d 1299 (4th Dist. 1989), and is included in the Appendix to this Petition at A33. The Interim Order and Final Order of the Illinois Commerce Commission are reported at 45 PUR 4th 5 (July 20, 1988), and 97 PUR 4th 189 (Nov. 22, 1988) respectively. The Illinois Commerce Commission Orders are included in the Appendix to this Petition at A73 and A90, respectively.

STATEMENT OF JURISDICTION

The decision of the Illinois Supreme Court was entered on June 4, 1991. This Petition for Writ of Certiorari is timely filed within ninety (90) days of that date. No Petition for Rehearing was filed by any party of record. On July 9, 1991, the Illinois Supreme Court granted the Motion of the Office of Public Counsel ("Petitioner" or "the OPC") to stay the issuance of its mandate pending the disposition of the Petition for a Writ of Certiorari. Jurisdiction of this Court is invoked under 28 U.S.C., sect. 1254 (1). The decision of the Illinois Supreme Court creates serious conflicts with United States Supreme Court case law and the Natural Gas Act ("NGA").

STATEMENT OF THE CASE

The question of whether the Illinois Supreme Court correctly ruled that the Illinois Commerce Comission ("ICC") is preempted by the Sixth Amendment and the filed rate doctrine from deciding take-or-pay allocation of gas liabilities in Illinois is a product of FERC gas policy of the late 1980's. The Federal Energy Regulatory Commission ("FERC") stated it intended all segments of the gas industry to carry the burden of take-

or-pay liabilities. This was to be achieved by state utility commissions allocating costs to implement the national policy set by FERC. Federal preemption entered the national take-or-pay problem[1] when state commissions, such as Illinois, ruled they were precluded from altering the prices of gas set by the FERC, based upon the Sixth Amendment and the filed rate doctrine. The gas costs at issue are not costs at all. These are gas liabilities which were not set by the FERC.

A. Background

The facts of this case arose out of the drastic changes that occurred in the natural gas industry in recent years. Prior to 1985, natural gas producers sold natural gas to pipeline companies which in turn transported and sold the gas to local distribution companies ("LDCs") which in turn, finally, sold the gas at retail to end-users. Interstate producers and pipelines are regulated by the Federal Energy Regulatory Commission and LDCs are regulated by both the FERC and by state utility commissions, such as the Illinois Commerce Commission.

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[1] Numerous states across the U.S. have decided the preemption issue in different ways. These states include: Indiana Utility Regulatory Commission at 97 PUR 4th 1 (1989); Maryland Public Service Commission at 99 PUR 4th 23 (1988); Delaware Public Service Commission at 116 PUR 4th 287 (1990); California Public Utilities Commission at 109 PUR 4th 1 (1990); Pennsylvania Public Utility Commission at 104 PUR 4th 185 (1989); and New Hampshire Public Utilities Commission in Docket(s) DR 91-042 and DR 91-045.

Virtually all contracts between pipelines and producers contained so-called "take-or-pay" clauses as a result of the gas shortages of the late 1970's. These clauses required pipelines to pay producers for a specified level of gas each year, whether or not it actually took that amount of gas. The reason that pipelines nationwide entered into these long-term take-or-pay contracts was due to expectations that the natural gas shortage of the 1970's would continue. However, by the mid-1980's, it became clear that the shortage had lapsed and natural gas companies were locked into the long-term, expensive contracts.

In 1985, the FERC adopted an "open-access" policy which meant that, for the first time, an LDC could bypass the pipeline as a wholesaler and purchase gas directly from a producer. The LDC could then transport the gas over the pipeline's distribution system at a substantially reduced cost. See FERC Order No. 436 (Oct. 18, 1985), 50 Fed. Reg. 42408, 33 FERC Statutes and Regulations, para. 61-007. Thus, gas could be bought and sold directly between producers and LDCs without using a pipeline as a middleman in the sale. This new FERC policy came at a time when there was a natural gas surplus -- as a result, a strong "spot market" was created. The spot market allowed LDCs to purchase gas directly from producers at unregulated prices which were much lower than FERC-approved pipeline rates.

Pipelines were therefore unable to sell all of the gas they were required to take under the take-or-pay clauses of the long-term contracts with gas producers. Additionally, pipelines were also unable to meet competition on the spot market by reducing their prices. Thus, take-or-pay costs grew to be billion dollar liabilities for gas pipelines throughout the nation, without any guidance or official word from the FERC pertaining to how the pipelines were to recover these costs.

B. Take-Or-Pay Liability Recovery

The FERC issued Order No. 500 on August 7, 1987 in which it established a policy for pipeline recovery of take-or-pay costs from LDCs. The FERC expressed the view that pipelines, distribution companies, and consumers are each to absorb a portion of the take-or-pay liabilities. FERC Order No. 500, 89 PUR 4th 312 (Aug. 7, 1987). This was part of an intent by FERC to initiate an "equitable sharing" among all segments of the industry, rather than passing liabilities on in full to the distributors.

Moreover, the FERC made it abundantly clear that effective nationwide regulation of its policy pertaining to take-or-pay costs could not occur without the active participation of state commissions. FERC foresaw the need for complimentary state prudence reviews and allocation measures when it acknowledged that its ability to implement a national policy on take-or-pay costs could be accomplished only through allocation at the state regulatory level. FERC Order No. 500, 89 PUR 4th at 319.[2] This Petition for Certiorari is filed because the Illinois Supreme Court decision is contrary to the FERC policy.

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[2] Under FERC policy, pipelines had two options to absorb liabilities. This allocation methodology is not at issue in this Petition for Certiorari. It should be noted, however, that the alternative mechanisms have been found to be illegal by the U.S. Court of Appeals for the District of Columbia Circuit, vacating and remanding the FERC's recovery mechanism by concluding that the purchase deficiency method violated the filed rate doctrine. Associated Gas Distributors v. FERC, 893 F.2d 349 (D.C. Cir. 1989), cert. denied., FERC v. Associated Gas Distributors, 112 L.Ed.2d 232, 111 S.Ct. 373 (Oct. 29, 1990).

Subsequent to briefing and oral argument before the Illinois Supreme Court, the FERC issued a new policy statement focusing on the collection of take-or-pay fixed charges. FERC Order No. 528, 117 PUR 4th 327 (Nov. 1, 1990). The new statement reiterated the FERC policy on equitable sharing. Order No. 528 states:

> The Commission reiterates its conviction that all segments of the industry must share the responsibility of paying for these transition costs.
>
> . . .
>
> The Commission reaffirms the principle that all segments of the industry - pipelines, producers, LDCs, industrial end-users, and other consumers - should contribute to funding the pipeline's take-or-pay costs.
>
> . . .
>
> To this end, the Commission urges state commissions to use the full extent of their authority to equitably allocate between LDCs and retail customers take-or-pay costs that flow through an interstate pipeline's rates. [Emphasis Added]

FERC Order No. 528, 117 PUR 4th 327, 332-34 (Nov. 1, 1990). The Commission continued to cite from Order No. 500-H[3] to emphasize its position "that nothing precludes a state commission from requiring an LDC to absorb a share of the costs as the [FERC] is requiring of interstate pipelines here." Id. This being the case, the Illinois Supreme Court found the ICC was precluded from requiring LDCs to absorb take or pay liabilities.

As stated, the Illinois Supreme Court Opinion conflicts with FERC policy. Additionally, the Illinois decision is inconsistent with the preemption doctrine, federal case law, and the intent of the NGA. Preemption arises only when there is a conflict in federal and state regulatory activity. Here, FERC has invited state activity, and there is clearly no preemption involved. Moreover, the Illinois Supremely

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[3] Order No. 500-H was one of numerous explanatory orders issued by the FERC subsequent to Order No. 500. FERC Order 500-H, FERC Statutes & Regulations, Regulation Preambles, (CCH) Para. 30,867 (1989)(Order No. 500-H). Order No. 500-H reaffirmed the FERC statements regarding equitable sharing and reiterated the options available to the States.

Court decision impedes the purpose of the NGA, which was enacted in order to prevent the gaps in regulation created certain segments of the industry are unduly burdened. The NGA was concieved to allow state commissions to regulate areas the federal agency could not, such as where gas is transported purely intrastate. Congress provided for state regulators to be able to set gas rates which are totally local in nature. Lastly, the General Motors Corp. opinion conflicts with recent rulings by this Court which speak to state commissions' ability to alter FERC set rates when dealing with interstate gas prices.

C. Orders of the Illinois Commerce Commission

By Order on April 27, 1988, the ICC initiated a general proceeding to investigate the recovery of direct-billed take-or-pay liabilities by all Illinois LDCs. On July 20, 1988, the ICC issued an interim order in which it found that it was prohibited under the filed rate doctrine and federal preemption from requring LDCs to share a portion of their take-or-pay costs with rateyapyers. According to the ICC, it was required, as a matter of law, to allow Illinois LDCs to recover from ratepayers all the take-or-pay liabilities allocated to LDCs by FERC. ICC Interim Order, 95 PUR 4th 5 (July 20, 1988)(A73). These costs, the ICC ruled, could not be subject to prudence reviews at the state level based upon the United States Supreme Court decision in Mississippi Power & Light Co. v. Mississippi, 487 U.S. 354, 101 L.Ed. 2d 322, 108 S.Ct. 2428 (1988) ("Mississippi Power").[4] On November 22, 1988, the ICC issued its Final Order concluding that the filed rate doctrine preempted it from not allowing distributors to recover the full costs imposed on the distributors as a result of FERC Order No. 500. ICC Final Order, 97 PUR 4th 189, 197-199 (Nov. 22, 1988)(A90).

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[4] The ICC ruled that FERC's statements regarding "equitable sharing" in Order No. 500 could not authorize a prudence hearing by any state agency. ICC Interim Order, 95 PUR 4th at 8-9.

D. The Appellate Court's Opinion

The Illinois Industrial Energy Consumers ("IIEC") and the Office of Public Counsel ("OPC") appealed the Commission's orders to the Illinois Appellate Court for the Fourth District. (See Ill. Rev. Stat. 1989, ch. 111 2/3, par. 10-201(a)). In a 2-1 decision, the Appellate Court correctly ruled that the ICC is not preempted by either the Supremacy Clause or the filed rate doctrine from reviewing the prudence of LDCs in incurring pipeline take-or-pay charges. General Motors Corp. v. ICC, 191 Ill. App. 3d 450, 464-465, 547 N.E. 2d 1299, 1305-1308 (4th Dist. 1989)(A65).

The Illinois Appellate Court held that the "[t]here is no basis for concluding State administrative agencies are precluded by either federal legislation or administrative rules from requiring LDC's to absorb some of their take-or-pay costs under appropriate circumstances." General Motors Corp., 191

Ill. App. 3d at 462, 547 N.E.2d at 1306(A56).[5] The majority construed FERC Order No. 500 as not precluding the ICC from requiring distributors to absorb some portion of the costs. According to the Appellate Court, neither Mississippi Power nor Nantahala, as relied upon by the LDCs, supports the proposition that "State regulatory agencies are prohibited by the preemption and filed-rate doctrines from denying LDC's full recovery of their take-or-pay liabilities." Id. (A57); Mississippi Power & Light Co. v. Mississippi, 487 U.S. 354, 101 L. 3d. 2d 322, 108 S. Ct. 2428 (1988) (involving FERC-mandated payments for nuclear power plant); Nantahala Power & Light Co. v. Thornburg, 476 U.S. 953, 90 L. Ed. 2d 943, 106 S. Ct. 2349

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[5] The court continued to rule that there is no basis to believe LDC absorption of some of the take-or-pay liabilities is impossible because compliance with FERC regulations and State administrative agency regulation would frustrate the overall scheme of utility regulation, or that the intent of Congress or the FERC would be frustrated by the ICC preventing full recovery of take-or-pay liabilities from consumers.

(1986) (involving FERC-approved allocations of low-cost federal power) ("Nantahala").[6] The Appellate Court remanded the cause to the ICC with directions to admit evidence on the sharing of costs and past prudence practices by LDCs. General Motors Corp., 191 Ill. App. 3d at 465, 547 N.E.2d at 1307-1308 (A65).

E. Illinois Supreme Court's Opinion

The Illinois Supreme Court reversed the judgment of the Fourth District Appellate Court and reinstated the order of the Commission. General Motors Corp. et al. v. ICC et al., 143 Ill.2d 407, 574 N.E.2d 650 (1991)(A32). Without a full analysis of the relevant case law, the Illinois Supreme Court reversed "based upon fundamental principles of

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[6] The majority concluded that, in contrast to the intent of FERC in Nantahala and Mississippi, FERC in this case did not intend to preempt state regulatory agencies from requiring distributors to absorb some of the take-or-pay costs. General Motors, Inc, 191 Ill. App. 3d at 463, 547 N.E.2d at 1306-1307 (A59).

Federal preemption . . . and consistent application of the filed rate doctrine, [which] prohibited the ICC from conducting prudence reviews of FERC-mandated take-or-pay costs." General Motors Corp., 143 Ill.2d 407, 424, 574 N.E.2d 650, 659 (A32).

Contrary to the FERC's statements in Order No. 500, the Illinois Supreme Court incorrectly ruled that the Illinois LDCs may use the preemption doctrine as a means of escaping all responsibility for the extraordinary costs of take-or-pay settlements being imposed on the entire natural gas industry. As a result of the Illinois Supreme Court's decision, the Illinois Commerce Commission is able to skirt FERC's intention that all segments of the natural gas industry -- producers, interstate pipelines, LDCs and customers -- share in the costs imposed by the take-or-pay settlements. FERC has jurisdiction over producers and interstate pipelines and has already required them to absorb some of the costs. Comparatively, the

Illinois Commerce Commission, which has jurisdiction over LDCs and consumers, has refused to further assign costs by pursuing the FERC policy as ordered by the FERC.

The United States Supreme Court is requested to determine whether the ICC is preempted from allocating take-or-pay liabilities to Illinois distributors based upon the Sixth Amendment's Supremacy Clause and the filed rate doctrine embodied in the NGA. The larger issue is what is the effect of a federal agency's expressed intent in the absence of Congressional expressions to preempt an area of regulation. The Illinois Supreme Court's analysis is flawed and must be reversed to clarify the issue for all regulatory commissions at the federal and state levels.

ARGUMENT

ISSUE NO. I

THE ILLINOIS COMMERCE COMMISSION IS NOT PREEMPTED BY EITHER THE SUPREMACY CLAUSE OR THE FILED RATE DOCTRINE FROM IMPLEMENTING FERC POLICY REGARDING THE ALLOCATION OF GAS COST LIABILITIES

In this case, the Illinois Supreme Court has incorrectly ruled that state commissions are totally preempted from allocating gas costs by the Sixth Amendment and the filed rate doctrine. This ruling raises an important question of federal law which has not been settled by this Court. Additionally, the Illinois Supreme Court's ruling in General Motors Corp. decided a federal question that conflicts with two U.S. Supreme Court decisions, Nantahala and Mississippi Power. Based upon a cursory review of applicable preemption law, the Illinois Supreme Court concluded, " . . . Congress intended Federal law to occupy the field of regulating interstate sale of wholesale gas. We are thus compelled in this context of FERC-mandated take-or-pay costs to adhere to the consistent application of the preemptive effect of the filed rate doctrine." General Motors Corp., 143 Ill.2d at 417, 574 N.E.2d at 656 (A18-A19). This holding is an improper ruling regarding the filed rate doctrine which conflicts with the NGA and is an inappropriate extension of both Nantahala and Mississippi Power.

Take-or-pay labilities are not FERC-approved allocations of costs or FERC-mandated payments. Rather, the issue is intrastate and is tied to FERC only through the policy statements issued by the FERC directing the states to allocate take-or-pay costs across all segments of the gas industry. The Illinois Supreme Court decision is inconsistent with the preemption doctrine, which arises when there is a conflict between state and federal authority. Where a federal statute does not preempt a field of regulation, and a federal agency invites activity through clear and concise statements of policy not to preempt state activity, then there is no preemption involved.

A. States Are Only Preempted by Federal Agency Action In Particular Circumstances

The federal preemption doctrine is derived from the Supremacy Clause of the U.S. Constitution, which invalidates all state laws that conflict or interfere with an act of Congress. Federal law may preempt state law in three circumstances:

> (1) the federal statutory language specifically preempts state regulation of the subject matter covered by the statute or regulation; (2) Congress or a federal administrative agency indicates an intention to occupy the entire field of regulation of a particular subject matter; or (3) compliance with both state and federal laws or regulations covering the same subject matter is impossible or the state law or administrative regulation in question poses an obstacle to accomplishment of a purpose or goal of Congress or a federal administrative agency. (See Hillsborough County v. Automated Medical Laboratories, Inc., 471 U.S. 707, 85 L.Ed.2d 714, 105 S.Ct. 2371 (1985); Michigan Canners & Freezers Association, Inc. v. Agricultural Marketing & Bargaining Board, 467 U.S. 461, 81 L.Ed.2d 399, 104 S.Ct. 2518 (1984); Capital Cities Cable, Inc. v.

Crisp, 467 U.S. 691, 81 L.Ed.2d 580, 104 S.Ct. 2694 (1984)) (A51-A52).

General Motors Corporation v. Illinois Commerce Commission, 191 Ill. App. 3rd at 547 N.E.2d at 1305.

None of those circumstances exist in this case. The legislative history of the Natural Gas Act, 15 U.S.C. Section 717 *et seq.* (1934) and the Federal Power Act, 16 U.S.C. Section 719 *et seq.* (1935), shows that there was no express intent of Congress to preempt states in cases such as the one before this Court, and there was no intent to occupy the entire field of natural gas regulation. Due to all states' inability to affect interstate energy rates, gaps in regulation of interstate rates were created. In response, Congress enacted the Federal Power Act and Natural Gas Act, which established federal regulation over most electric and gas utilities engaged in interstate commerce. *Id*.

The language in the NGA demonstrates the intention of Congress to allow the states to continue to regulate intrastate gas service. That act provides in part:

> The provisions of this chapter shall not apply to any person engaged in...the transportation in interstate commerce or sale in interstate commerce for resale, of natural gas received by such person from another person within or at the boundary of a state _if all the natural gas so received is ultimately consumed within such state_..._provided that the rates and service of such person_..._be subject to regulation by a state Commission_. The matters exempted from the provisions of this chapter by this subsection are declared to be matters primarily of local concern and subject to regulation by the several states.

15 U.S.C. sec. 717(c) 1982. [Emphasis Added].

This Court has found that in enacting the NGA, "[Congress] had no purpose or effect to cut down state power . . . Perhaps its primary purpose was to aid in making state regulation effective, by adding the weight of federal regulation to supplement and reinforce it in the gap created by the prior decisions." _Panhandle Eastern Pipe Line Company v. Public Service Commission of Indiana_, 332 U.S. 507, 517, 92 L.Ed. 128, 68 S.Ct. 190 (1947). It is apparent that Congress neither expressly declared that it intended to preempt state regulation of utilities, nor did it intend to fully occupy regulation of the natural gas industry.

In comparison, the Illinois Supreme Court completely overlooked relevant federal case law on the preemptive force of the NGA and cited to general statements of the FERC's plenary and exclusive authority to regulate the natural gas industry to conclude the NGA totally precludes any state action. General Motors Corp., 143 Ill.2d at 414-415, 574 N.E.2d at 655 (A14). Moreover, the Court overlooked relevant U.S. Supreme Court cases interpreting the FERC's ability to state its intention not to preempt state regulation of gas utilities within the respective states. See Cal. Coastal Comm'n v. Granite Rock, 480 U.S. 572, 94 L.Ed.2d 577, 107 S.Ct. 1419 (1987). Additionally, the Illinois Supreme Court bypassed U.S. Supreme Court cases which spoke directly to Congress' intent in enacting the NGA and to regulating the natural gas industry. It is clear the jurisdiction of the FERC, previously the Federal Power Commission, was to complement that of the state regulatory commissions. Federal Power Commission v. Panhandle Eastern Pipe Line, 337 U.S. 498, 69 S.Ct. 1251, 1255, 93 L.Ed. 1499 (1949). The enactment of the NGA did not intend federal regulation of the total natural gas industry, to the exclusion of the states. Id. The Illinois Supreme Court has created case law inconsistent with U.S. Supreme Court caselaw by ruling one-hundred and eighty degrees in the other direction, contrary to settled constitutional law. General Motors Corp., 143 Ill.2d at 416-417, 574 N.E.2d at 656 (A18-A19).

Additional review of the development of the preemption doctrine in natural gas proceedings shows that the Illinois Supreme Court incorrectly determined that the preemption and filed rate doctrines have preempted state commissions from requiring the LDCs to share a portion of the take-or-pay costs. The "filed rate doctrine" started out as a principle of ratemaking that was entirely separate from the Supremacy Clause and the preemption doctrine. As first articulated in Montana-Dakota Utilities Co. v. Northwestern Public Service Company, 341 U.S. 246, 71 S.Ct. 692, 95 L.Ed. 912 (1951), the filed rate doctrine requires that the rate filed with and approved by FERC's predecessor, the federal Power Commission, is the only legitimate rate. The Supreme Court later found that the filed rate doctrine affects both the companies subject to the Act and the regulator: "[T]he Act bars a regulated seller of natural gas from collecting a rate other than the one filed with the Commission and prevents the Commission itself from imposing a rate increase for gas already sold. Arkansas Louisiana Gas Co. v. Hall, 453 U.S. 571, 578, 101 S.Ct. 2925, 2931, 69 L.Ed. 856 (1981). Arkansas Louisiana Gas Co. also transformed the doctrine into a rule of preemption under which state courts must recognize the inviolability of wholesale rates on file with or approved by FERC.

Numerous state courts applied the filed rate doctrine, finding that their state commissions must give effect to FERC determined rates. The Illinois Supreme Court was one of the first, holding that the Commission must allow the recovery of federally approved natural gas wholesale rates. City of Chicago v. Illinois Commerce Commission, 13 Ill.2d 607, 150 N.E.2d 776 (1958).

In the field of wholesale electric power, the leading case was Narragansett Electric Co. v. Burke, 119 R.I. 559, 381 A.2d 1358 (1977), cert. denied, 435 U.S. 972, 56 L.Ed.2d 63, 98 S.Ct. 1614 (1978), which held that state commissions must allow local utilities to recover the costs of wholesale rates that had been approved by FERC. This Court recently decided a related issue in Nantahala Power & Light v. Thornburg, 476 U.S. 953, 106 S.Ct. 2349, 90 L.Ed.2d 943 (1986) and Mississippi

Power, 487 U.S. 354, 108 S.Ct. 2488, 101 L.Ed.2d 322 (1988). In Nantahala, this Court determined that the FERC decisions on allocations of interstate power, which directly affect wholesale rates, should be given the same status as filed rates. Similarly, in Mississippi Power this Honorable Court found that the FERC had exclusive jurisdiction to set power allocations, and that states cannot bar utilities from passing on FERC-mandated wholesale rate to retail customers as a result of interstate power allocations by the FERC. Neither of these situations exist in the instant case.

As noted by the Illinois Appellate Court, neither Mississippi Power nor Nantahala requires that the ICC be preempted from allocating some portion of the take-or-pay costs to the LDCs.

> In both Nantahala and Mississippi Power, there was a readily apparent intention on the part of the FERC to preempt the entire field of allocation of power produced by interstate electricity pools. The Supreme Court merely gave effect to this intention." General

Motors Corporation v. ICC, 547 N.E.2d at 1307.

Those cases therefore represent the most compelling case for FERC preemption. Interstate electric pools must be able to recover all of the costs assigned by FERC to each utility. Otherwise, costs could be "trapped" by a renegade state and never could be recovered. The Supreme Court has merely affirmed the action of the FERC stepping in and preventing actions that could frustrate the purposes of the NGA.

The Illinois Appellate Court correctly determined that the filed rate doctrine does not apply, however, where FERC has interpreted its own statute to allow states to allocate some of the take-or-pay cost to LDCs. FERC has stated that its take-or-pay policy is based on "an equitable sharing of take-or-pay costs among all segments of the industry, including producers, pipelines, distributors and consumers." Order No. 500, 89 PUR 4th 312, 327. Furthermore, the gas liabilities included in the instant case are purely intrastate in nature. These are not interstate filed rates by the FERC which could not be altered by state commissions. Thus, the liabilities in question do not fall within the filed rate doctrine. Reversal of the Illinois Supreme Court's decision will insure that the FERC's policy, and every statement by a federal agency to have state regulatory bodies implement federal policy, will be pursued uniformly by all states.

B. The NGA Does Not Express An Intent To Fully Occupy The Field of Natural Gas Regualtion

The statutory language of the NGA makes it apparent that, in enacting the NGA, Congress intended to generally leave to State regulatory agencies the regulation of the rates of LDCs. The provisions of NGA do not apply to persons engaged in the transportation, sale or resale of gas in interstate commerce if all the natural gas received is ultimately consumed within such

State. The matters exempted from this section are subjects of local concern and subject to regulation by State regulatory commissions. 15 U.S.C. Section 717(c) (1982). Moreover, for further guidance, agency's rules are to be relied on as an interpretation of federal law. Thus, when the United States Congress does not state its intention to wholly preempt a regulatory field, courts must turn to the applicable federal administrative agency regulations, on the subject matter at hand, to determine whether the federal agency intended to preempt State regulation. Hillsborough County, 471 U.S. 707, 105 S.Ct. 2371, 85 L. Ed. 2d 714 (1985).

Therefore, the first step in any preemption analysis is whether or not Congress expresses an intent to fully occupy a particular area of regulation, such as the regulation of interstate pipelines. Hillsborough County v. Automated Medical Laboratories, Inc., 471 U.S. at 717, 105 S.Ct. at 2377, 85 L.Ed. 2d at ___. However, when it is obvious that Congress did not intend to occupy the whole field of regulation, leaving no room for regulation by the states, a federal agency's expressed intent to allow states to compliment a field of regulation becomes the second part of the preemption analysis. Since Congress did not totally preempt the field of state gas regulation and the FERC intended for states to implement an equitable sharing of all take-or-pay liabilities to all segments of the gas industry, as discussed previously, the Illinois Supreme Court created law which conflicts with federal constitutional law. It is contrary to the NGA and constitutional law rulings to hold that state commissions are unable to pursue regulation of FERC's equitable sharing policy. Non-preemption of local ratemaking discretion results from the fact that Congress did not fully reserve pipeline ratemaking for federal authority, and the States are not prohibited, directly or indirectly, from reviewing the allocation of take-or-pay liabilities. Yet, that is exactly what the Illinois Supreme Court has effectuated.

C. FERC Has Stated Its Intention Not to Preempt the States from Assigning Some Take-or-Pay Liability to the LDCs

In evaluating the preemption issue in this case, this Court must look to FERC's intent that all the parties in the natural gas industry pay a share of take-or-pay costs. The FERC has spoken directly on this issue in Order No. 500 through No. Order 500-I and Order No. 528. In those Orders, FERC expressed its statement of policy not to preempt state authorities from assigning to LDCs some take-or-pay liabilities. FERC's clear, succinct and unambiguous language reveals that the federal agency wanted states to allocate take-or-pay costs to LDCs so that those costs could be spread across the whole industry to producers, pipelines, distribution companies and the consumers.

Order 500 does not attempt to prescribe a method by which approved pipeline take-or-pay costs are to be allocated at the state level. In fact, FERC specifically announced in Order No. 500 that "the development of cost allocation procedures and rates for the LDCs are matters to be determined by the state regulatory authority." 89 PUR 4th at 331.

In Order 500, FERC did not assess blame to any party for the natural gas industry's take-or-pay problems. FERC instead decided that the transition costs of restructuring the industry should be shared by producers, pipelines, LDCs and customers:

> The causes of the pipelines' take-or-pay problems are many and complex. It is undoubtedly true that some pipelines imprudently entered into contracts incorporating both high prices and high take-or-pay levels. At the same time, pipelines entered into contracts, which were based on the anticipated demands of their customers, and whose terms reflected those which producers were able to obtain under the then prevailing market conditions. In many instances, pipeline take-or-pay obligations mounted because of reduced purchases by their customers due to purchases

> from alternative suppliers, fuel switching by industrial users due to lower fuel oil prices, reduced levels of economic activity, and conservation. The Commission recognizes that it is difficult to assign blame for the pipeline industry's take-or-pay problems. In brief, no one segment of the natural gas industry or particular circumstance appears wholly responsible for the pipelines' excess inventories of gas. As a result, all segments should shoulder some of the burden of resolving the problem. [Emphasis added].

89 PUR 4th at 318-319.

FERC went on to note its limited sphere of jurisdiction and that it was not attempting to prescribe methods and allocations of take-or-pay costs at the state level. Referring specifically to the restrictions placed on state public utility commissions by Nantahala, FERC stated:

> As previously noted, the proposed policy statement does not attempt to prescribe the methods by which approved pipeline take-or-pay costs are to be allocated at the state level. However, it is the Commission's view that there should be an equitable sharing of take-or-pay costs among all segments of the industry. The issue therefore is whether there exists any basis to expect that state agencies will be

> able to effect a sharing of pipeline take-or-pay costs as between LDCs and their customers.

Id., p. 331.

Finally, FERC acknowledged the limits of its own jurisdiction and the need for states to step in and complete the process of requiring all segments of the natural gas industry to share in the absorption of take-or-pay costs:

> The Commission can exercise its jurisdiction only within its legitimate sphere, which in this instance involves establishing cost allocation procedures and rates for recovery by pipelines of take-or-pay costs from their jurisdictional customers. The development of cost allocation procedures and rates for the LDCs are matters to be determined by state regulatory authorities.

Id. at 331.

Although there should have been a little doubt about FERC's intent, the Commission and the LDCs argued to the Illinois Supreme Court that it was not clear whether FERC indicated a desire not to preempt. The Illinois Supreme Court inappropriately accepted those arguments. All possible doubt should have ended on December 13, 1989, when FERC issued Order 500-H.

In Order 500-H, issued after the Appellate Court decision, FERC reaffirmed its previous holding in Order 500 that there should be an equitable sharing of liability and that state commissions have the ability to conduct prudence reviews to determine how equitable sharing can be conducted. Furthermore, FERC reaffirmed its prior conclusion that Nantahala did not preclude state regulators from reviewing prudence practices of LDCs as they affect take-or-pay costs. FERC stated:

> The Commission reaffirms its view stated in Order No. 500 that there should be an equitable sharing of take-or-pay costs among all segments of the industry. As the Commission stated in Order No. 500, state regulators may consider reclassifying, as commodity costs, take-or-pay costs billed to an LDC as a fixed charge and incorporating such costs into LDC sales or transportation rates, or both, thereby spreading such costs to the maximum extent possible and subjecting them to market forces. Furthermore, state regulatory agencies may implement, as some have, an equitable sharing

> *mechanism similar to that established by the Commission which requires LDCs to absorb a portion of the costs if they desire to assess a fixed charge*.
>
> The Commission also reaffirms its conclusion that the Supreme Court's decisions in *Nantahala Power and Light Co. v. Thornburg*, or subsequent cases, *do not preclude state regulators from reviewing the prudence of LDCs' purchasing decisions insofar as they affect take-or-pay costs*. While *Nantahala* held that "a state may not conclude in setting retail rates that the FERC-approved wholesale rates are unreasonable," the Court did not decide the issue whether a state agency can inquire into an LDC's prudence in choosing to pay the FERC-approved wholesale rate of one supplier, as opposed to the lower rate of another supplier.

FERC Order 500-H, 49 FERC par. 61,325, slip opinion at 200-201 (December 13, 1989). [Emphasis Added].

FERC denied requests for rehearing of Order 500-H, specifically rejecting the requests of LDCs that the FERC withdraw its comments regarding the state agencies ability to disallow some recovery of take-or-pay settlement costs. FERC Order 500-I; 50 FERC par. 61,172 (February 12, 1990).

The FERC has recently restated its expressed intent for all segments of the gas industry to bear the burden of take-or-pay liabilities in its Order No. 528. FERC Order No. 528, 117 PUR 4th 327 (Nov. 1, 1990). The FERC's Order No. 528 is the response to the United States Court of Appeals for the District of Columbia Circuit's vacating and remanding FERC's allocation methodology which, the court ruled, violated the filed rate doctrine. Associated Gas Distributors v. FERC, 893 F.2d 349 (D.C. Cir. 1989), cert. denied, FERC v. Associated Gas Distributors, 112 L.Ed.2d 332, 111 S.Ct. 373 (Oct. 29, 1990). The allocation issue is not present in this Petition for Certiorari requesting review of federal preemption power of the NGA and the FERC.

D. A Federal Agency's Interpretation Of Its Own Enabling Statute Is Entitled to Deference When The Interpretation Does Not Violate The Plain Meaning Of The Statute

The Illinois Supreme Court's decision is inconsistent with a line of United States Supreme Court cases which speak directly to a federal agency's power to declare its intention in the area of preemption. These cases all hold for the unquestionable ability of a federal agency to express its intent not to preempt state regulatory bodies when Congress has not occupied a particular field of regulation. More specifically, the Illinois Appellate Court cited to Mississippi Power for the following:

> FERC's interpretation of its authority under the relevant legislation is entitled to deference where, as here, "it does not violate [the] plain meaning [of applicable legislation] and is a reasonable interpretation of silence or ambiguity." Mississippi Power and Light Company v. Mississippi, 487 U.S. at 380, 108 S.Ct. at 2443, 101 L.Ed.2d at 344 (Scalia, J., concurring).

General Motors v. Illinois Commerce Commission, 191 Ill. App. 3d at 461-462, 547

N.E.2d at 1306(A56). Therefore, there is no basis for ruling that State regulatory agencies are prevented by either Congress's the NGA or the FERC's administrative rules from requiring LDCs to absorb a portion of the take-or-pay liabilities.

Justice Scalia's comment in Mississippi Power is consistent with the law that has been established by the Supreme Court requiring that agencies speak clearly when preempting. Where a statute does not manifest an attempt to totally preempt an entire field of regulation, and the federal administrative rules do not express an intent to preempt, then state regulators are not precluded from setting their standards consistent with the federal scheme. "It is appropriate to expect an administrative regulation to declare any intention to preempt state law with some specificity." Cal. Coastal Comm'n v. Granite Rock, 480 U.S. 572, 582-584, 94 L.Ed.2d 577, 593, 107 S.Ct. 1419, 1445-1446 (1987).

The U.S. Supreme Court fully illustrated its understanding of the NGA in Federal Power Commission v. Panhandle Eastern Pipe Line, 337 U.S. 498, 69 S.Ct. 1251, 1255, 93 L.Ed. 1499 (1949). The Court explained, "[w]ithout entering upon...[a]...review of [the Act's] legislative history, suffice to say that the NGA did not envisage federal regulation of the entire natural-gas field to the limit of constitutional power. Rather, it contemplated the exercise of federal power as specified in the Act, . . . The jurisdiction of the Federal Power Commission was to complement that of the state regulatory bodies." Panhandle, 332 U.S. 498, 503-504, 69 S.Ct. 1251, 1255, 93 L.Ed. 128. Furthermore, the Court in Panhandle went on to hold that the obvious meaning of the Act's words is a clear expression of congressional intent. Panhandle, 332 U.S. at 505, 69 S.Ct. at 1256, 93 L.Ed. ___.

The Supreme Court has provided further case law on which to determine the preemptive power of congressional and regulatory intent.

The Supreme Court has made it clear that an intent to preempt a field of regulation cannot be inferred from the comprehensiveness of the regulations at issue. As stated in New York Social Services v. Dublino, 413 U.S. 405, 415, 37 L.Ed. 2d 688, 696, 93 S.Ct. 2507, 2514 (1973), "[T]he subjects of modern social and regulatory legislation often by their very nature require complex responses from Congress, but without Congress necessarily intending its enactment as the exclusive means of meeting the problem." The Court found that even though the federal scheme was comprehensive, there was room for complementary state work incentive programs and procedures. The New York rules aided the objectives of federal work incentives.

The United States Supreme Court extended the "comprehensiveness" argument a step further in Hillsborough County, Fla. v. Automated Medical Laboratories, Inc., 471 U.S. 707, 85 L.Ed.2d 714, 105 S.Ct. 2371 (1985). The Court stated:

> We are even more reluctant to infer preemption from the comprehensiveness of regulations than from the comprehensiveness of statutes. As a result of their specialized functions, agencies normally deal with problems in far more detail than does Congress. To infer preemption whenever an agency deals with a problem comprehensively is virtually tantamount to saying that whenever a federal agency decides to step into a field, its regulations will be exclusive.

Id., 471 U.S. at 717, 85 L.Ed.2d 723-724, 105 S.Ct. at 2377.

This particular case dealt with local county adopted ordinances implementing regulations regarding donor testing and record keeping for blood plasma centers. These rules were challenged on the basis that they conflicted with federal blood plasma regulations promulgated by the Food and Drug Administration. "Courts can expect that agencies will make intentions clear if regulations are intended to be exclusive. Therefore, where an agency is silent as to the question of preemption, volume and complexity of regulations alone does not indicate that the agency did in fact intend to preempt." Id., 471 U.S. at 718, 85 L.Ed.2d at 724, 105 S.Ct. at 2377.

The Illinois Supreme Court's decision in General Motors Corp. is out of line with relevant constitutional law from the United States Supreme Court. The cases discussed above directly outline a federal agency's power to declare its intention in the area of preemption. It is clear that once analysis of the pertinent statute reveals that Congress did not intend to occupy the entire field of regulation of that particular subject area, then a federal agency's regulatory scope is to be determined. Thus, the FERC's interpretation of its authority is entitled to deference when it does not violate the purpose and meaning of the NGA.

CONCLUSION

For the reasons set forth above, Petitioner respectfully suggest that the issuance of a writ of certiorari should be appropriate under the issues presented for review.

Respectfully
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ILLINOIS SUPREME COURT OPINION
[JUNE 4, 1991]

Docket Nos. 69853, 69856, 69857, 69865 cons.-
Agenda
25-September 1990.
GENERAL MOTORS CORPORATION et al.. Appelles.
v. THE ILLINOIS COMMERCE COMMISSION et al..
Appellants.

CHIEF JUSTICE MILLER delivered the opinion of the court:

This case involves the efforts of Illinois natural gas distribution companies (distributors) to pass through to their customers the "take-or-pay" costs which the Federal Energy Regulatory Commission (FERC) requires distributors to pay to help relieve interstate gas pipeline companies (pipelines) of the pipelines' take-or-pay obligations to gas producers before FERC allowed distributors to purchase gas directly from producers. The issue before this court is whether the Illinois Commerce Commission (ICC) must allow distributors to recover these costs in full from ratepayers, pursuant to the "filed rate doctrine." The filed rate doctrine is a rule of Federal preemption that requires States to give binding effect to rates filed with and approved by FERC.

Following an extensive investigation of the take-or-pay issue, the ICC determined that it was preempted from disallowing recovery of any portion of the FERC-approved costs. (Re Costs Associated With Take-or-Pay Charges (Ill. Com. Comm'n 1988), 95 Pub. Utilities Rep. 4th 5.) The Illinois Industrial Energy Consumers (Industrial Consumers) and the Office of Public Counsel (Public Counsel) appealed. With one justice dissenting, the appellate court reversed the ICC order. (191 Ill. App. 3d 450.) The distributors and the ICC appealed to this court. (See 134 Ill. 2d Rules 315(a), 317.) We allowed their petitions for leave to appeal, and we now reverse the judgment of the appellate court and reinstate the order of the ICC.

Background

Until 1985, Illinois distributors purchased natural gas almost exclusively from interstate pipeline companies at FERC-approved rates. The pipelines in turn purchased gas supplies directly from gas producers pursuant to long-term contracts. During the natural gas shortage of the 1970s, virtually all contracts between pipelines and producers contained "take-or-pay" clauses, which required pipelines to purchase a certain amount of gas each year or pay for any gas not taken.

In 1985, FERC adopted an "open-access policy," which meant that, for the first time, a distributor could purchase gas directly from a producer and transport the gas over an interstate pipeline, without using the pipeline as a wholesaler. (See FERC Order No. 436 (Oct. 18, 1985), 50 Fed. Reg. 42408, 33 FERC Statutes and Regulations par. 61,007.) The new policy coincided with a natural gas surplus, creating a strong "spot" market in which distributors could purchase gas directly from producers at unregulated prices that were often much lower than FERC-approved pipelines rates.

Distributors who took advantage of the spot market were required to pass on the cost savings directly and entirely to their customers. The savings were substantial; the average residential consumer's rates were reduced 21% as a result of spot purchases. (FERC Order No. 500-H (Dec. 21, 1989), 54 Fed. Reg. 52344, 49 FERC Statutes and Regulations par. 30,519, citing State Treatment of Take-or-Pay Settlement Costs, 17 Gas Energy Rev. 2, 3 (Sept. 1989).) The American Gas Association estimated that spot purchases resulted in consumer savings that were six times greater than the take-or-pay costs in question here. FERC Order No. 500-H (Dec. 21, 1989), 54 Fed. Reg. 52344, 49 FERC Statutes and Regulations par. 30,867, citing 17 Gas Energy Rev. at 3.

Although FERC's open-access policy was beneficial to consumers, it created huge potential liabilities for pipelines, whose gas costs were often locked in at high prices by their long-term take-or-pay contracts. Unable to reduce their prices to meet competition from the spot market, pipelines could not sell all of the gas they were required to take or pay for under their contracts with producers. As a result, pipelines were subject to billions of dollars of take-or-pay liability to producers. In the two years following FERC's adoption of the open-access policy, pipeline take-or-pay liability continued to accumulate, with no indication from FERC as to how the pipelines might handle the take-or-pay obligations.

In August 1987, FERC issued Order No. 500, which established a framework for pipelines to recover the take-or-pay costs from distributors. (FERC Order No. 500 (Aug. 14, 1987), 52 Fed. Reg. 30334, 40 FERC Statutes and Regulations par. 61,172.) In that Order, FERC expressed the view that pipelines ought to absorb some of the take-or-pay costs, rather than pass them on in full to the distributors, as port of an "equitable sharing" of the costs throughout the industry. FERC offered pipelines two alternative mechanisms for recovering portions of the take-or-pay costs from distributors.

Under the first alternative, pipelines could refuse to absorb any of the costs voluntarily and could seek full recovery of whatever portion of the take-or-pay costs FERC found to be prudently incurred. If a pipeline chose this option, however, it could recover its prudently incurred take-or-pay costs only by adding them to the cost of gas sold in the future, and distributors could avoid the charges by reducing their purchases.

FERC's second alternative offered pipelines guaranteed recovery of up to 50% of the take-or-pay costs, which could be direct-billed to distributors at a fixed rate, if the pipeline agreed to absorb an equal amount of the cost it charged distributors. The two alternatives were not mutually exclusive. A pipeline could use the second option to recover a portion of the costs (up to 50%) and the first option to recover the remainder.

To prevent distributors from avoiding the take-or-pay charges under the second alternative, FERC imposed the charges on distributors that had purchased gas from the pipeline during a particular period regardless of whether those distributors currently continued to do business with the pipeline. The costs were allocated among distributors based on each distributor's contribution to the pipeline's decline in sales between two set periods, generally before and after the open-access policy took effect. As a result, those distributors who had taken advantage of the open-access spot market to achieve lower costs for ratepayers were assigned higher take-or-pay obligations than were distributors who had continued to purchase higher cost gas from pipelines when lower cost gas was available directly from producers. (See Associated Gas Distributors v. Federal Energy Regulatory Comm'n (D.C. Cir. 1989), 893 F.2d 349 (striking down this "purchase deficiency" method of allocating take-or-pay costs on grounds that it constituted retroactive ratemaking and violated the filed rate doctrine).) In the present case, this court is not called upon to determine the issue raised in American Gas Distributors but only to decide whether the ICC is preempted from disallowing distributors full recovery, from their customers, of the FERC-allocated take-or-pay costs.

Pipelines serving distributors in the present case uniformly elected the second alternative, which ensured them recovery of a portion of their take-or-pay costs from distributors. The pipelines submitted their take-or-pay costs to FERC for a determination that the costs were just and reasonable. Once that determination was made, FERC approved the take-or-pay rates to be direct-billed to distributors.

On April 27, 1988, the ICC began a general proceeding to investigate how Illinois distributors would recover the take-or-pay costs form their customers. All Illinois natural gas distributors were joined as parties. Intervening in the action were the Public Counsel and the Industrial Consumers, a group of 16 large, Illinois industrial energy consumers. As part of the proceeding, the ICC considered arguments submitted by a number of distributors, the ICC's staff, the Industrial Consumers, and the Public Counsel. On November 22, 1988, the ICC issued a final order concluding that the filed rate doctrine preempted it from not allowing distributors to recover fully the costs imposed on distributors as a result of FERC Order No. 500. The ICC therefore authorized Illinois distributors to recover from their customers, all of the FERC-allocated take-or-pay costs.

The Industrial Consumers and the Public Counsel appealed the ICC order to the appellate court. (See Ill. Rev. Stat. 1989, ch. 111 2/3, par. 10-201.) They argued that the filed rate doctrine did not apply to the take-or-pay costs and that the ICC should conduct prudence reviews to determine whether distributors had properly incurred the costs. The appellate court, with one justice dissenting, reversed the ICC's order. 191 Ill. App. 3d 450.

The appellate court held that the preemption analysis turned on whether FERC intended to preclude State regulatory commissions from determining recovery of the take-or-pay costs. (191 Ill. App. 3d at 462-65.) The majority construed FERC Order No. 500 as not precluding the ICC from reviewing take-or-pay costs or from requiring distributors to absorb some portion of the costs. The majority distinguished the present matter from two recent United States Supreme Court cases in which the Court held that the filed rate doctrine prohibited State interference with distributors' recovery of FERC-approved costs. Mississippi Power & Light Co. v. Mississippi ex rel. Moore (1988), 487 U.S. 354, 101 L. Ed. 2d 322, 108 S. Ct. 2428 (involving FERC-mandated payments for nuclear power plant); Nantahala Power & Light Co. v. Thornburg (1986), 476 U.S. 953, 90 L. Ed. 2d 943, 106 S. Ct. 2349 (involving FERC-approved allocations of low-cost Federal power).

The appellate court reasoned that the Court in Nantahala and Mississippi Power merely gave effect to FERC's intent to preempt State authority in certain interstate power allocation decisions. (191 Ill App. 3d at 463.) The majority concluded that, in contrast to the intent of FERC in those cases, FERC in this case did not intend to preempt State regulatory agencies from requiring distributors to absorb some of the take-or-pay costs. 191 Ill. App. 3d at 463.

The appellate court remanded the cause to the ICC with directions to admit evidence on two issues: the sharing of the distributors' take-or-pay costs between distributors and ratepayers, and "the factors relevant to the prudence of the past purchasing practices of the [distributors] as they relate to take-or-pay costs." (191 Ill. App. 3d at 465.) The latter would required the ICC to conduct what is called a "prudence review" of the distributors' past purchasing decisions.

The dissenting justice believed that the filed rate doctrine preempted the ICC from conducting a prudence review and furthermore that the doctrine required the ICC to allow recovery by distributors from their customers of the costs as reasonable operating expenses because FERC had determined that the take-or-pay costs were part of the wholesale cost of power. (191 Ill App. 3d at 466 (Lund. J., dissenting).) The dissent also noted that the ICC already had approved the distributors' purchasing decisions, at the time the decisions were made. 191 Ill. App. 3d at 468 (Lund. J., dissenting).

In the present appeal, the distributors and the ICC contend that the ICC is preempted from interfering with the full recovery of FERC-mandated take-or-pay costs. The Industrial Consumers and the Public Counsel submit that FERC intended and equitable sharing of the costs by all segments of the natural gas industry and that the appellate court, in allowing the ICC to review the take-

or-pay costs and determine whether distributors should absorb some of the costs, properly gave effect to FERC's intentions.

Federal Preemption and the Filed Rate Doctrine

We begin our analysis with a review of the preemptive effect of the Natural Gas Act (1 U.S.C. sect. 717 et seq. (1988)), as construed by the courts in the filed rate doctrine. The relevant statutory provisions are sections 1(a), 4, and 5 of the Act. Section 1(a) provides in relevant part:

> "[I]t is declared that the business of transporting and selling natural gas for ultimate distribution to the public is affected with a public interest, and that Federal regulation in matters relating to the transportation of natural gas and the sale thereof in interstate and foreign commerce is necessary in the public interest." (15 U.S.C. sect. 717(a) (1988).)

Complementing this broad declaration of purpose, sections 4 and 5 of the Act provide for pervasive regulation of pipeline rates and charges by FERC.

The filed rate doctrine is an outgrowth of "straight-forward principles" of Federal preemption. (Arkansas Louisiana Gas Co. v. Hall (1981), 453 U.S. 571, 577, 69 L. Ed. 2d 856, 863-64, 101 S. Ct. 2925, 2930.) The preemptive authority of the filed rate doctrine arises from section 4 of the Natural Gas Act (Arkansas Louisiana, 453 U.S. at 577, 69 L. Ed. 2d at 863, 101 S. Ct. at 2930) and is mandated by the supremacy clause of the United States Constitution. U.S. Const., art. VI. cl. 2; Nantahala Power & Light Co. v. Thornburg (1986), 476 U.S. 953, 90 L. Ed. 2d 943, 106 S. Ct. 2349.

In enacting the Natural Gas Act, Congress gave exclusive and plenary authority to FERC to regulate the transportation and sale for resale of natural gas moving in interstate commerce, including the power to regulate interstate commerce, including the power to regulate interstate natural gas prices. (Northern Natural Gas. Co. v. State Corp. Comm'n (1963), 372 U.S. 84, 91, 9 L. Ed. 2d

601, 607, 83 S. Ct. 646, 650-51; Illinois Natural Gas Co. v. Central Illinois Public Service Co. (1942), 314 U.S. 498, 506-09, 86 L. Ed. 371, 376, 62 S. Ct. 384, 387-88.) Indeed, in Illinois Natural Gas, the United States Supreme Court explicitly confirmed Congress' intent as expressed in the Natural Gas Act to "occupy the field" in regulating interstate natural gas rates and services. Illinois Natural, 314 U.S. at 506-09, 86 L. Ed. at 376-78, 62 S. Ct. at 387-88.

From Congress' intent in the Natural Gas Act, as applied to rates approved by the Federal commission, the Supreme Court pronounced the rule of Federal preemption known as the filed rate doctrine. (Montana-Dakota Utilities Co. v. Northwestern Public Service Co. (1951), 341 U.S. 246, 95 L. Ed. 912, 71 S. Ct. 692.) The Montana-Dakota Court stated that "the right to a reasonable rate is the right to the rate which the [Federal] Commission files or fixes, and *** except for review of the Commission's orders,

[a] court[] can assume no right to a different one on the ground that, in its opinion, it is the only or the more reasonable one." Montana-Dakota, 341 U.S. at 251-52, 95 L. Ed. at 919, 71 S. Ct. at 695.

This court has long recognized that the Natural Gas Act preempts the ICC from directly or indirectly setting natural gas rates. (City of Chicago v. Illinois Commerce Comm'n (1958), 13 Ill. 2d 607.) Confirming the preemptive effect of FERC-set rates, the United States Supreme Court recently held that when a State regulatory commission determines intrastate retail rates, it must give binding effect to interstate power rates filed with FERC or fixed by FERC. Nantahala, 476 U. S. at 962, 90 L. Ed. 2d at 951, 106 S. Ct. at 2354.

We must reject the Industrial Consumers' suggestion that the take-or-pay costs are extraordinary one-time charges that are not subject to Federal preemption under the filed rate doctrine. The filed rate doctrine applies to the take-or-pay costs at issue here because they are FERC-approved costs associated with the procurement of gas from wholesale suppliers. (Nantahala, 476 U.S. at 966, 90 L. Ed. 2d at 954, 106 S. Ct. at 2356-57.) Citing with approval this court's decision in City of Chicago, the Supreme Court in Nantahala noted that State courts have broadly applied the filed rate doctrine in several contexts in which FERC had established wholesale power prices. (Nantahala, 476 U.S. at 956-66, 90 L. Ed. 2d at 954, 106 S. Ct. at 2356.) We believe that the preemptive effect of the filed rate doctrine encompasses the FERC charges in this context as well.

It is clear from the legislative history and express language of the Natural Gas Act, and from the consistent pronouncements by the Supreme Court, that Congress intended Federal law to occupy the field of regulating interstate sale of wholesale gas. We are thus compelled in this context of FERC-mandated take-or-pay costs to adhere to the consistent application of the preemptive effect of the filed rate doctrine.

FERC's Intent

The Industrial Consumers and the Public Counsel argue that the appellate court in this case correctly held that the preemption issue here turns on FERC's intent as expressed in Order no. 500. In Order No. 500, FERC stated that "it is the commission's view that there should be an equitable sharing of take-or-pay costs among all segments of the industry." The Order also stated that, in FERC's view, States were not legally precluded from reviewing distributors' prudence in incurring the take-or-pay costs. (FERC Order No. 500 (Aug. 14, 1987), 52 Fed. Reg. 30334, 40 FERC Statutes and Regulations par. 61,172.) The appellate court relied on this language in determining that the ICC was not preempted from reviewing and disallowing portions of the FERC-approved costs.

After the appellate court announced its decision in this case, FERC issued Order No. 500-H (FERC Order No. 500-H (Dec. 21, 1989), 54 Fed. Reg. 52344, 49 FERC Statutes and Regulations par. 30,867.) In that subsequent Order, FERC presented its interpretation of the constitutional implications of the filed rate doctrine. FERC concluded that prudence reviews by State agencies in the take-or-pay context would not contravene Congress' intent in enacting the Natural Gas Act. In the order, FERC specifically suggested that State utility commissions may properly conduct prudence reviews of direct-billed take-or-pay charges or design methods for inducing distributors to agree "voluntarily" to absorb a portion of the costs in order to effectuate a policy of "sharing" the costs. FERC summarily reaffirmed these views in Order No. 500-I (Feb. 26, 1990), 55 Fed. Reg. 66050, 50 FERC Statutes and Regulations par. 30, 880.

We reject, on several grounds, the argument that FERC's intent determines the preemptive effect of the filed rate doctrine on distributors' recovery of take-or-pay costs. Setting forth the basic inquiry governing the review of a regulatory agency's interpretation of its own powers, the Supreme Court has stated, "If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress." (Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc. (1984), 467 U.S. 837, 842-43, 81 L. Ed. 2d 694, 703, 104 S. Ct. 2778, 2781.) For the reasons that follow, we conclude that FERC's intent is irrelevant to the application of the filed rate doctrine in the context of retail ratemaking.

As our discussion of the Natural Gas Act and the filed rate doctrine demonstrates, the preemptive force of FERC-approved costs and allocations is derived from Federal statute and the supremacy clause of the Constitution. FERC cannot rewrite the statutory provisions of the Natural Gas Act and has no authority to deviate from the clear intent of Congress. When FERC promulgates regulations, it cannot dispense with the supremacy clause and the intent of Congress by saying that it believes inconsistent State regulation is permissible.

A recent application of the filed rate doctrine demonstrates that, contrary to the arguments advanced by the Industrial Consumers and the Public Counsel, the intentions of FERC as expressed in Order No. 500 and Order No. 500-H have no power to alter the preemptive effect of the Natural Gas Act. (Columbia Gas Transmission Corp. v. Federal Energy Regulatory Comm'n (D.C. Cir. 1990), 895 F.2d 791.) The Columbia Gas court, in allowing distributors to recover in full costs similar to the take-or-pay costs at issue here, explicitly rejected the proposition that FERC's intent, as expressed in its orders, determines whether the filed rate doctrine applies in a given case. (Columbia Gas, 895 F.2d at 797.) The court stated that is was unaware of "any principle in equity or law that empowers an agency to ignore explicitly legislative commands in order to mitigate the damage its errors of judgment or rulemaking delays may have caused." (Columbia Gas, 895 F.2d at 797.) Similarly, though FERC may view preemption as an obstacle to the proper resolution of the take-or-pay problems created by the open-access policy, the agency is not empowered to alter the legislatively mandated preempted effect of its earlier decisions.

Additionally, even though FERC has authority and expertise generally to adopt new policies when faced with new developments in the industry, it has no power to adopt a policy that direct conflict with its governing statute. (See Maislin Industries, U.S., Inc. v. Primary Steel, Inc. (1990), 497 U.S. ____, 111 L. Ed. 2d 94, 110 S. Ct. 2759 (Interstate Commerce Commission has no authority to deviate from filed rates, despite its pleas that such deviation was required in light of deregulation of motor carrier industry).) In this case, FERC's suggestion that State regulatory commissions are free to conduct prudence reviews and make arrangements for "sharing" of take-or-pay costs is directly at odds with the policy of the filed rate doctrine. The Supreme Court has consistently acknowledged that the filed rate doctrine prohibits a State commission from "trapping" FERC-approved wholesale costs, which would occur if a State commission prevented a distributor from full recovering those wholesale costs in retail rates. (Mississippi Power, 487 U.S. 354, 101 L. Ed. 2d 322, 108 S. Ct. 2428; Nantahala, 476 U.S. at 970, 90 L. Ed. 2d at 956, 106 S. Ct. at 2358-59.) Thus, the filed rate doctrine not only ensures the integrity of FERC proceedings (Mississippi Power, 487 U.S. at 375, 101 L. Ed. 2d at 340, 108 S. Ct. at 2440-41) but also protects distributors from the trapping of wholesale costs (Mississippi Power, 487 U.S. at 372, 101 L. Ed. 2d at 339, 108 S.Ct. at 2439; Nantahala, 476 U.S. at 970, 90 L. Ed. 2d at 956, 106 S. Ct. at 2358-59). We find no source of authority empowering FERC to withdraw that protection in order to implement the "equitable" solutions it has suggested in Order No. 500-H.

While the Industrial Consumers and the Public Counsel may believe that FERC's suggestions provide a pragmatic solution to the take-or-pay liabilities, FERC's solution suffers a significant infirmity. As the above discussion demonstrates, FERC's suggestion ignore the constitutional limitations on the States' power to deny full recovery of FERC-mandated pipeline charges. Our decision in this case turns on the will of Congress, as unambiguously expressed in the provisions of the Natural Gas Act. (See Chevron, 467 U.S. at 842-43, 81 L. Ed. 2d at 703, 104 S. Ct. at 2781.) Here the intent of Congress is clear and controlling: "States may not bar regulated utilities from passing through to retail consumers FERC-mandated wholesales rates." Mississippi Power, 887 U.S. at 372, 101 L. Ed. 2d at 338, 108 S. Ct. at 2439. See also Nantahala, 476 U.S. at 970, 90 L. Ed. 2d at 956, 106 S. Ct. at 2358-59; City of Chicago, 13 Ill. 2d at 616.

Prudence Review

The appellate court in this case directed the ICC on remand to "admit evidence pertaining to *** the factors relevant to the prudence of the past purchasing practices of the [distributors] as they relate to take-or-pay costs." (191 Ill App. 3d at 465). We believe, however, that the filed rate doctrine prohibits State prudence review of FERC-mandated costs (Mississippi Power, 487 U.S. at 375, 101 L. Ed. 2d at 340-41, 108 S. Ct. at 2440-41), and we find no exception to the filed rate doctrine under the circumstances here.

Without deciding the issue, the Supreme Court has acknowledged the exception to the filed rate doctrine articulated in Pike County Light & Power Co. v. Pennsylvania Public Utility Comm'n, (1983), 77 Pa. 268, 273-74, 465 A.2d 735, 737-38, and Kansas-Nebraska Natural Gas Co. v. State Corp. Comm'n, (1980), 4 Kan. App. 2d 674, 679-80, 610 P.2d 121, 127. Under that exception, States retain the authority to review the prudence of a distributor's actions in incurring FERC-approved supply charges when the distributor had a choice whether to incur the charge. (Mississippi Power, 487 U.S. at 373-74, 101 L. Ed. 2d at 339-40, 108 S. Ct. at 2440; Nantahala, 476 U.S. at 972, 90 L. Ed. 2d at 958, 106 S. Ct. at 2359-60.) For example, a State regulatory agency could find that purchase of a particular quantity of power from a particular source was unreasonable if lower cost power was available elsewhere, even if the cost of the purchased power had been approved by FERC and therefore deemed reasonable, Mississippi Power, 487 U.S. at 373, 101 L. Ed. 2d at 340, 108 S. Ct. at 2440; Nantahala, 476 U.S. at 972 L. Ed. 2d at 958, 108 S. Ct. at 2360.

That exception to the filed rate doctrine does not apply here, for the distributors in this case cannot avoid the current take-or-pay charges. (Mississippi Power, 487 U.S. at 374, 101 L. Ed. 2d at 340, 108 S. Ct. at 2440.) As the appellate court acknowledged, the FERC-approved take-or-pay costs and the FERC-approved allocation of those costs are mandatory. (191 Ill. App. 3d at 464.) Under orders issued by FERC, the distributors are liable to the pipelines for the take-or-pay costs regardless of any actions the distributors may take now or in the future, even if they cease purchasing gas from the pipeline imposing the charge.

Because FERC has allocated the sharing of costs in such a manner that distributors have no opportunity to accept or reject the amount billed, the ICC may not conduct a prudence review of the take-or-pay charges for the purpose of determining whether some part of the allocated costs may or may not be recovered through the distributor's rates. (Mississippi Power, 487 U.S. at 374, 101 L. Ed. 2d at 340, 108 S. Ct. at 2440.) State prudence review under these circumstances would be an impermissible collateral attack on the reasonableness of FERC's cost allocations and could result in an impermissible trapping of FERC-mandated costs. (Mississippi Power, 487 U.S. at 373 n.12, 101 L. Ed. 2d at 339 n.12, 108 S. Ct. at 2439 n.12.) The ICC is not empowered, through the artifice of a prudence review, to trap federally mandated costs. See Mississippi Power, 487 U.S. at 372, 101 L. Ed. 2d at 339, 108 S. Ct. at 2439. See also Kentucky West Virginia Gas Co. v. Pennsylvania Public Utility Comm'n, (3d Cir. 1988), 862 F.2d 69, 74 ("the principles of Nantahala Power and Mississippi Power" prohibited State prudence review of a distributor's mandatory costs-identical in effect to the take-or-pay clauses at issue here-because the distributor could not avoid the costs).

We find that the case before us presents no exception to the filed rate doctrine. Indeed, this case presents the classic situation for application of the doctrine, for it involves an intermediary faced with a FERC-set wholesale rate, who would, if the doctrine were not applied, be forced to sell power at less than its reasonable cost as determined by FERC. Nantahala, 476 U.S. at 969, 90 L. Ed. 2d at 956, 106 S. Ct. at 2358.

Moreover, even if in this case the filed rate doctrine permitted State review of distributors' past purchasing decisions it would be difficult to say in what respect distributors have been imprudent in incurring these particular costs. The distributors did not know and could not have foreseen at the time that those purchasing decisions would lead to the imposition of direct-billed take-or-pay costs years later. Until 1985, when FERC issued Order No. 436 establishing the open-access policy, no one knew that the long-term take-or-pay contracts between pipelines and producers would create multibillion dollar liabilities for the pipelines. And it was not until FERC issued Order No. 500 in 1987 that distributors had any idea that pipeline take-or-pay liabilities would be passed on to them. (See Associated Gas Distributors v. Federal Energy Regulatory Comm'n, (D.C. Cir. 1989), 8893 F.2d 349, 356 (rejecting the suggestions that FERC's decision in Order No. 500 could have been anticipated based on "hints" in a 1984 FERC decision).) By that time, the purchasing decisions that the appellate court has directed the ICC to review for prudence had long since been made.

As the distributors point out in their briefs to this court, unless clairvoyance has become an element of prudence, there simply is no basis on which the ICC could conduct a meaningful prudence review. In light of our result, we do not consider the separate argument by the distributors and the ICC that a prudence review under these circumstances would be inconsistent with Illinois law. See Business & Professional People for the Public Interest v. Illinois Commerce Comm'n, (1988), 171 Ill. App. 3d 948, 959.

In sum, we hold that fundamental principles of Federal preemption, as reflected in the longstanding and consistent application of the filed rate doctrine, prohibit the ICC from conducting prudence reviews of FERC-mandated take-or-pay costs. Illinois distributors must be allowed to pass through to their customers the full amount of these charges. Accordingly, we reverse the judgment of the appellate court and reinstate the order of the ICC.

Appellate court reversed;
Illinois Commerce Commission order affirmed.

JUSTICE BILANDIC and HEIPLE took no part in the consideration or decision of this case.

ILLINOIS APPELLATE COURT OPINION
[DECEMBER 5, 1991]

NOS. 4-89-0101, 4-89-0105

IN THE APPELLATE COURT

OF ILLINOIS

FOURTH DISTRICT

GENERAL MOTORS CORPORATION,) Administrative
et al.)) Review of
) Illinois
) Commerce
) Commission
v. (4-89-0101))
) No. 88-0103
ILLINOIS COMMERCE)
COMMISSION, et al.)
)
Respondents.)
)
THE PEOPLE OF THE STATE)
OF ILLINOIS)
ex rel. THE OFFICE OF)
PUBLIC COUNSEL,)
)
Petitioner,)
v. (4-89-0105)) No. 88-0103
)
GENERAL MOTORS CORPORATION,)
et al.)

JUSTICE KNECHT delivered the opinion of the court:

In recent years, there have been drastic changes in the distribution and sale of natural gas in this country. Traditionally, most local distribution companies (LDC's)--the companies which sell natural gas at retail to consumers--purchased their natural gas from pipeline companies, which in turn purchased natural gas from other pipeline companies or from natural gas producers. Thus, the main function of most natural gas pipeline companies was to sell natural gas to LDC's. During the period subsequent to 1978, however, many purchasers of natural gas, including LDC's, sought to purchase gas directly from producers at lower rates than those charged by the pipeline companies. An obstacle to this practice was an unwillingness on the part of the pipeline companies to transport natural gas from producers to the LDC's. The pipelines feared transportation to their LDC customers of natural gas which the customers purchased directly from producers would reduce their own sales of natural gas. Re Regulation of Natural gas After Partial Wellhead Decontrol (1987), 52 Fed. Reg. 30,334, 89 Pub. Utilities Rep. 4th 312 (hereinafter Order 500).

A factor which made natural gas pipelines especially reluctant to incur any reduction in their sales of natural gas was "take or pay" clauses contained in contracts with gas producers into which the pipeline had entered during the natural gas shortages of the late 1970's and early 1980's. These clauses "obligate a pipeline (a) to take a specified quantity of gas over a specific period of time, (b) to make prepayments to the producer for the quantity of gas not so taken, and (c) to "make up" [take] the volumes not so taken but already covered by such prepayments, also over a specific period of time." C.F. Phillips, Jr., Deregulation of Public Utilities: Theory and Practice 602 (1984).

In 1985, the Federal Energy Regulatory Commission (FERC) found the refusal of pipelines to transport natural gas for entities which purchased the gas from third parties was discriminatory and caused increased costs to consumers by denying them access to natural gas at the lowest reasonable prices. Therefore, FERC (1) required all pipelines performing "self-implementing transportation," to provide such transportation on a nondiscriminatory basis and thereby become "open access pipelines," (2) required pipelines which are required to become "open access pipelines" to eliminate rate structures which favor their merchant function over their transportation function, (3) required pipelines to allow their "firm sales customers" to alter the amount of gas they are contractually required to purchase by either reducing that level or converting it from firm sales to firm transportation, (4) adopted procedures designed to ease the entry of pipelines into new markets so that LDC's who had access to only one pipeline would have access to others, and (5) provided for expedited abandonment of gas subject to "reduce takes." Re Regulation of Natural Gas Producers After Partial Wellhead Decontrol (1985), 33 F.E.R.C. par. 61,007, 50 Fed. Reg. 42,408, modified (1985), 50 Fed. Reg. 52, 217, modified further (1986), 51 Fed. Reg. 6,398, Rehearing denied (1986), 34 F.E.R.C. par. 61,404, rehearing denied (1986), 34 F.E.R.C. par 61,405, reconsideration denied (1986), 34 F.E.R.C. par. 61,403 (hereinafter Order 436).

In Order 500, FERC addressed a matter which it did not discuss in Order 436--the relief to be afforded pipelines which had burdensome take-or-pay contract obligations. FERC stated:

> [I]t is difficult to assign blame for the pipeline industry's take-or-pay problems. In brief, no one segment of the natural gas industry or particular circumstance appears wholly responsible for the pipelines' excess inventories of gas. As a result, all segments should shoulder some of the burden of resolving the problem. (Order 500, 52 Fed. Reg. at 30,337, 89 Pub. Utilities Rep. 4th at 318-19.)

In Order 500, FERC adopted two alternative mechanisms for relief from take-or-pay contract obligations, which enabled pipelines to recover portions of their costs of "buying out" or "buying down" such contracts. Under the first alternative, pipelines may recover in their "sales commodity charges," all such costs which were "prudently incurred." Under the second alternative, pipelines which transport gas on a nondiscriminatory basis under FERC's regulations may elect to assume an equitable share (from 25% to 50%) of the costs of buying out or buying down their take-or-pay contracts and may recover an equal share of such costs through fixed charges to their customers. The remaining amounts of take-or-pay contract buy out and buy down expenses can be recovered through "a commodity surcharge or volumetric charge on total pipeline throughout." Order 500, 52 Fed. Reg. at 30,341, 89 Pub. Utilities Re. 4th at 325.

On April, 27, 1988, the Illinois Commerce Commission (ICC) began an investigation into the manner in which Illinois LDC's may recover the take-or-pay contract buy out or buy down costs which they are required to pay to their pipelines. In an interim order issued July 20, 1988, the ICC noted pipelines are uniformly opting for the second take-or-pay cost recovery mechanism permitted by FERC, under which they may direct bill a percentage of their take-or-pay costs to their customers. In that order the ICC concluded the doctrine of Federal preemption and the "filed rate" doctrine (see Mississippi Power & Light Co. v. Mississippi (1988), 487 U.S. , 101 L. Ed. 2d 322, 108 S. Ct. 2428; Nantahala Power & Light Co. v. Thornburg (1986), 476 U.S. 953, L. Ed. 2d 943, 106 S. Ct. 2349) prohibit it from preventing LDC's from recovering the FERC-approved take-or-pay costs which are allocated to them. The ICC further held presentation of evidence was required concerning the questions of whether the LDC's take-or-pay costs can be recovered through the mechanism of the LDC's uniform purchased gas adjustment clauses (Ill. Rev. Stat. 1987, ch. 111 2/3, par. 9-220) and whether the LDC's take-or-pay costs should be recovered through rates applicable to all categories of customers. The ICC also concluded any offsetting decreases in LDC expenses unrelated to take-or-pay costs could not be considered in determining the amount of such costs which LDC's can recover. Re Costs Associated with Take-or-pay Charges (Ill. Com. Comm's 1988), 95 Pub. Utilities Rep. 4th 5.

In a further order entered on November 22, 1988, the ICC denied a request for reconsideration of its July 20, 1988, interim order. In its November 22, 1988, order, the ICC held take-or-pay charges which are direct billed to LDC's should preferably be recovered through the LDC's uniform purchased gas adjustment clauses and allocated on a "uniform volumetric basis to both sales and transportation customers." LDC's are, however, free to propose recovery vehicles for take-or-pay costs other than recovery of such costs through their uniform purchased gas adjustment clauses. Re Costs Associated with Take-or-pay Charges (Ill. Com. Comm'n 1988), 97 Pub. Utilities Rep. 4th 189, 200.

Petitioners Illinois Industrial Energy Consumers (IIEC) and State of Illinois Office of Public Counsel (OPC), appeal the ICC's July 20, 1988, and November 22, 1988, orders. Essentially, both the IIEC and the OPC assert neither the Federal preemption doctrine nor the filed-rate doctrine support the ICC's decision it has no choice but to allow LDC's to recover the full amount of the take-or-pay costs which they must pay to pipeline companies. They assert rather, the ICC could conduct a prudence review of the purchasing practices of Illinois LDC's to absorb portions of their take-or-pay costs of deemed appropriate. Also, the IIEC maintains because of the ICC's decision regarding the applicability of the preemption and filed-rate doctrines, it improperly struck testimony concerning the sharing of take-or-pay costs between LDC's and rate payers and factors relevant to a prudence review of the past natural gas purchasing practices of the LDC's as they relate to their take-or-pay costs. Furthermore, the OPC asserts the ICC's conclusion take-or-pay costs should normally be recovered through the mechanism of purchased gas adjustment clauses is contrary to the Public Utilities Act (Ill. Rev. Stat. 1987, ch. 111 2/3, par. 1-101 et seq.), because take-or-pay charges do not represent amounts which the LDC's pay for natural gas.

The respondents--the ICC and several LDCs--maintain the ICC's decision is correct in all respects. The core of the respondents' argument is the ICC properly held the Federal preemption and the filed-rate doctrines preclude it from denying LDC's full recovery of their take-or-pay costs. They further assert (1) the LDC's are obligated to pay the take-or-pay charges which have been billed to them, (2) there was nothing which they could have done to avoid those charges immediately before they were assessed, and (3) there is nothing which they can presently do to avoid payment of those charges. They assert the ICC is thus precluded from considering the prudence of the gas purchases of the LDC's which resulted in their incurring take-or-pay obligations. They also assert the cost savings of LDC's, which resulted from their purchases of lower priced natural gas, but on the basis of which the take-or-pay charges were subsequently assessed, were passed on to the customers of the LDC's in the form of lower natural gas rates. Respondents assert contrary to petitioners' contentions, the statements of FERC, as well as the actions of FERC with regard to recovery by pipeline companies of their take-or-pay costs, support the conclusion State regulatory agencies may not deny LDC's the right to recover all take-or-pay costs for which they are liable. Respondents maintain even if FERC's statements did support this conclusion, FERC has no power to define the preemptive effect of its regulations. Also, respondents argue the ICC properly concluded LDC's may recover take-or-pay costs through their uniform purchased gas adjustment clauses, since under long-standing ICC practice, charges for items which may not be related to the actual amount of gas purchased, such as minimum gas charges and demand charges, may nevertheless be recovered through uniform purchased gas adjustment clauses.

Respondents Peoples Gas, Light, and Coke Company, North Shore Gas Company, and Central Illinois Public Service Company also argue the ICC's July 20, 1988, order was an appealable order. They contend since this order was not appealed in a timely manner, we may not now consider on review the question of whether the ICC is precluded by the Federal preemption and filed-rate doctrines from denying the LDC's full recovery of their take-or-pay costs. Furthermore, respondent Northern Illinois Gas Company (NI) argues the failure of petitioners to appeal an ICC order entered December 21, 1988, allowing it to recover its take-or-pay costs in its rates, precludes petitioners from obtaining review of the ICC's July 20, 1988, and November 22, 1988, orders insofar as they relate to NI.

We first consider whether the ICC's interlocutory order of July 20, 1988, insofar as it addressed the applicability of the Federal preemption and filed rate doctrines, was an appealable order. The Public Utilities Act provides in pertinent part:

> "No appeal shall be allowed from any rule, regulation, order or decision of the Commission unless and until an application for a rehearing thereof shall first have been filed with and finally disposed of by the Commission ***." (Ill. Rev. Stat. 1987, ch. 111 2/3, par. 10-113.)
> "Within 30 days after the service of any order or decision of the Commission refusing an application for a rehearing of any rule, regulation, order or decision of

> the Commission, including any order granting or denying interim rate relief, or within 30 days after the service of any final order or decision of the Commission upon and after a rehearing of any rule, regulation, order or decision of the Commission, including any order granting or denying interim rate relief, any person or corporation affected by such rule, regulation, order or decision, may appeal to the appellate court of the judicial district in which the subject matter of the hearing is situated, order if the subject matter of the hearing is situated in more than one district, then of any one of such districts, for the purpose of having the reasonableness or lawfulness of the rule, regulation, order or decision inquired into and determined." (Ill. Rev. Stat. 1987, ch. 111 2/3, par. 10-201.)

The statutory language relevant to this subject, as contained in the legislation which was in force prior to enactment of the Public Utilities Act (Ill. Rev. Stat. 1983, ch. 111 2/3, pars. 71, 72), is substantially the same. Under the legislation in effect prior to enactment of the Public Utilities Act, interlocutory ICC orders were not deemed appealable. (People v. Illinois Commerce Comm'n (1983), 114 Ill. App. 3d 384, 448 N.E.2d 986 (order granting interim rate relief); Candlewick Lake Utilities Co, v.

Illinois Commerce Comm'n (1978), 65 Ill. App. 3d 185, 382 N.E.2d 88 (order granting discovery request).) As noted by respondents Peoples Gas, Light, and Coke Company, North Shore Gas Company, and Central Illinois Public Service Company, the result in People v. Illinois Commerce Comm'n was, in effect, overturn by the enactment of legislation permitting appeal of ICC orders granting interim rate relief. (Ill. Rev. Stat. 1987, ch. 111 2/3, pars. 10-113, 10-201.) However, this legislation obviously has no impact on the appealability of interlocutory ICC orders other than those granting interim rate relief.

As the court observed in Candlewick Lake Utilities Co., allowing appeals from all interlocutory administrative agency orders would create interminable delays in administrative proceedings. For this reason, and because there is no Illinois case law supporting the appealability of orders such as the ICC's July 20, 1988, order, we hold that order was not an appealable order. In view of this conclusion, there is obviously no basis for respondents' contention we may not consider the merits of the ICC's decision relating to the applicability of the Federal preemption and filed-rate doctrines.

Respondent NI argues since the ICC on December 21, 1988, approved a tariff allowing NI to collect take-or-pay costs in the rates charged its customers (ICC docket No. 88-105), and petitioners did not appeal that order, petitioners are precluded from obtaining review of the ICC's July 20, 1988, interlocutory order and November 22, 1988, final order insofar as they relate to NI. We cannot accept this argument. The order in ICC docket No. 88-105 permitting NI to collect take-or-pay costs from its customers merely gives effect to the ICC's July 20 and November 22, 1988, decisions. Absent these prior decisions, there would be no basis for the ICC's order in ICC docket No. 88-105. Because the order in ICC docket No. 88-105 merely enforced the ICC's July 20, 1988, and November 22, 1988, orders, we hold it was not necessary for petitioners to also appeal the order in ICC docket no. 88-105 in order to obtain review of the former two orders.

The principles applicable to review of ICC orders are well established. The ICC's findings and conclusions as to questions of fact must be held _prima facie_ true and correct, and the ICC's decisions shall be held _prima facie_ reasonable. (Ill. Rev. Stat. 1987, ch. 111 2/3, par. 10-201(d).) Ordinarily, the ICC's decisions are entitled to great weight and deference. However, reviewing courts are not bound by the ICC's decisions as to legal issues, and the ICC's decisions as to those issues are not entitled to a presumption of _prima facie_ correctness. _Citizens Utilities Co. of Illinois v. Illinois Commerce Comm'n_ (1987), 153 Ill. App. 3d 28, 504 N.E.2d 1367, _aff'd_ (1988), 124 Ill. 2d 195, 529 N.E.2d 510.

Preemption of State laws and administrative regulations by Federal statutes or administrative regulations occurs under three circumstances: (1) the Federal statutory language specifically preempts State regulation of the subject matter covered by the statute or regulation; (2) Congress or a Federal administrative agency indicates an intention to occupy the entire field of regulation of a particular subject matter and to thereby preempt State regulation of the subject matter; or (3) compliance with both State and Federal laws or regulations covering the same subject matter is impossible or the State law or administrative regulation in question poses an obstacles to accomplishment of a purpose or goal of Congress or a Federal administrative agency. (See Michigan Canners & Freezers Association, Inc. v. Agricultural Marketing & Bargaining Board (1984), 467 U.S. 461, 81 L. Ed. 2d 399, 104 S. Ct. 2518; Capital Cities Cable, Inc. v. Crisp (1984), 467 U.S. 691, 81 L. Ed. 2d 580, 104 S. Ct. 2694; Hillsborough County v. Automated Medical Laboratories, Inc. (1985), 471 U.S. 707 85 L. Ed. 2d 714, 105 S. Ct. 2371.) The "filed-rate doctrine" is an extension of the preemption doctrine. For our purposes here, it is designed to ensure the integrity of regulation by FERC of interstate sales of electricity and natural gas at wholesale. Under this doctrine, a State regulatory agency generally may not exercise its authority over retail sales of power or natural gas to prevent an entity which buys power or gas at wholesale and sells it at retail from recovering its costs of paying FERC-approved rates for the power or gas. However, exceptions to this doctrine exist where, for instance, a utility purchases an excessive amount of high-cost power at FERC-approved rates which it could have purchased at a lower cost. In this situation, a State regulatory agency may prevent a utility from recovering a portion of the costs of high-

priced power or natural gas, even though it was purchased at FERC-approved rates. (See Nantahala, 476, U.S. 953, 90 L. Ed. 2d 943, 106 S. Ct. 2349.) In Mississippi Power & Light Co., the Court succinctly summarized the true import of the filed-rate doctrine:

> "The reasonableness of rates and [interstate power allocation] agreements regulated by FERC may not be collaterally attacked in state or federal courts. The only appropriate forum for such a challenge is before [FERC] or a court reviewing [FERC's] order." (Emphasis added.) Mississippi Power & Light Co., 487 U.S. at ,101 L. Ed. 2d at 340, 108 S. Ct. at 2440.

The Natural Gas Act provides in part:

> "The provisions of this chapter shall not apply to any person engaged in *** the transportation in interstate commerce or the sale in interstate commerce for resale, of natural gas received by such person from another person within or at the boundary of a State if all the natural gas so received is ultimately consumed within such State *** provided that the rates and service of such person *** be subject to regulation by a State commission. The matters exempted from the provisions of this chapter by this subsection are declared to be matters primarily of local concern and subject to regulation by the several States." 15 U.S.C. sect. 717(c) (1982).

On the basis of the above statutory language, it is apparent the congressional intent in enacting the Natural Gas Act was to generally leave to State regulatory agencies the regulation of the rates of LDC's. Where Congress does not manifest a clear intention to preempt a field of regulation, resort must be had to the applicable Federal administrative agency regulations in order to determine whether State regulation of the matter in question is preempted. (Hillsborough County, 471 U.S. 707, 85 L. Ed. 2d 714, 105 S. Ct. 2371.) In order 500, FERC stated:

> "As previously noted, the proposed policy statement does not attempt to prescribe the methods by which approved pipeline take-or-pay costs are to be allocated at the state level. However, it is the Commission's view that there should be an equitable sharing of take-or-pay costs among all segments of the industry. The issue therefore is whether there exists any basis to expect that state agencies will be able to effect a sharing of pipeline take-or-pay costs as between LDC's and their customers.
>
> The Commission does not believe that Nantahala precludes state regulators from designing LDC rates,

> or, in appropriate circumstances, from reviewing the prudence of LDCs' purchasing decisions insofar as they affect take-or-pay costs. It must be recognized that a fixed charge for take-or-pay costs is based on the need for assured recovery in light of a pipeline's agreement to absorb a comparable share of its take-or-pay costs. It is not based on the fact that the cost included in the charge are fixed costs. As the Commission has noted, take-or-pay settlement costs are actually related to the acquisition of gas supply and are considered as production-related. Therefore the Commission believes state regulators could consider reclassifying take-or-pay costs billed as a fixed charge as commodity costs and incorporating such costs into LDC sales or transportation rates, or both, thereby spreading such costs to the maximum possible extent as well as subjecting them to market forces. Alternatively, state agencies may wish to consider the option of not reclassifying fixed take-or-pay charges and instead allocating such charges to the LDC's customers based on their cumulative purchase deficiencies." (Emphasis added.) Order 500, 52 Fed. Reg. at 30,344-45, 89 Pub. Utilities Rep. 4th at 331.

Normally, one can expect an administrative agency will make its intentions clear if it intends for its regulations to have a preemptive effect. (California Coastal Comm'n v. Granite Park Co. (1987), 480 U.S. 572, 94 L. Ed. 2d 577, 107 S. Ct. 1419;

Hillsborough County, 471 U.S. 707, 85 L. Ed. 2d 714, 105 S. Ct. 2371.) In this case, FERC, in promulgating its regulations regarding recovery of take-or-pay costs, manifested an intention not to preempt State regulatory agency decisions which might require LDC's to share with rate payers (i.e., absorb) a portion of their take-or-pay costs. FERC's interpretation of its authority under the relevant legislation is entitled to deference where, as here, "it does not violate [the] plain meaning [of applicable legislation] and is a reasonable interpretation of silence or ambiguity." Mississippi Power & Light Co., 487 U.S. at , 101 L. Ed. 2d at 344, 108 S. Ct. at 2443 (Scalia, J., concurring).

There is thus no basis for concluding State administrative agencies are precluded by either Federal legislation or administrative rules from requiring LDC's to absorb some of their take-or-pay costs under appropriate circumstances. Moreover, there is no basis for holding (1) compliance with both FERC regulations governing take-or-pay costs and a State administrative agency regulation or decision requiring LDC's to absorb some of their take-or-pay costs would be impossible, or (2) the ICC preventing full recovery of LDC take-or-pay costs would frustrate a purpose or goal of Congress of FERC.

In support of their position State regulatory agencies are prohibited by the preemption and filed-rate doctrines from denying LDC's full recovery of their take-or-pay costs, respondents rely mainly on Mississippi Power and Nantahala. Neither of these decisions support that conclusion.

Mississippi Power involved a nuclear power plant owned entirely by subsidiaries of a parent corporation. FERC allocated the costs of the plant to each of the subsidiary companies in proportion to its relative demand for power. The United States Supreme Court held a State regulatory commission could not review the prudence of the investment of one of the subsidiary operating companies in the plant and thereby possibly deny it the right to recover its FERC-allocated costs of the plant.

Likewise, in Nantahala, a utility was allocated a certain percentage of low-cost Tennessee Valley Authority power. A State regulatory agency issued an order which would have required the utility to calculate its rates as if FERC had allocated it a larger percentage of the low-cost power than FERC actually did. The United States Supreme Court reversed a State court decision which affirmed the regulatory agency's decision, on the basis States may not alter FERC-ordered allocations of power by substituting their own judgments as to what would be a fair and reasonable allocation for those of FERC.

In both of the above cases, there was a readily apparent intention on the part of FERC to preempt the entire field of allocation of power produced by interstate electricity pools. The Supreme Court merely gave effect to this intention. In the present case, by contrast, FERC manifested an intention not to be preempt action by the State regulatory agencies requiring LDC's to absorb portions of their take-or-pay costs. Courts may not accord a preemptive effect to Federal statutes or administrative agency rules or orders when there is not stated intention whatsoever on the part of either Congress or a Federal administrative agency, the statutes, rules, or orders in question are to have a preemptive effect.

Respondents also rely to a great extent on the following language contained in FERC's order in Re United Gas Pipeline Co., (1988) 45 F.E.R.C. par. 61,335, at 62,054, 99 Pub. Utilities Rep. 4th 343, 344-45:

> "LDC's rates are regulated exclusively by state and local rate setting agencies. However, those agencies are preempted from questioning or altering the wholesale rates set by this Commission. Instead, they must allow their regulated LDC's to recover in retail rates the costs incurred as a result of paying the wholesale rates

> determined by this Commission. Consequently, state and local rate setting agencies take a special role in this Commission's proceedings. That role is recognized in Commission regulations that grant automatic party status to state commission that file timely notices of intervention. By participating in a pipeline's take-or-pay recovery proceeding under Order No. 500 on the issue of prudence, state and local rate setting agencies are pursuing their only opportunity to examine the reasonableness of the take-or-pay costs of their regulated companies' supplier and thereby have some input into the determination by this Commission of the amount of that supplier's take-or-pay costs to be recovered through fixed charges. Granting the relief sought would turn those agencies' participation into no more than an empty exercise." (Emphasis added.)

An examination of the full text of this decision reveals the above passage was quoted out of context by respondents. As is demonstrated by the following language, this decision dealt solely with challenges by State administrative agencies to the prudence of pipeline (as opposed to LDC) purchases of natural gas from producers and other suppliers:

> "Philadelphia Electric and the joint Advocates assert that the Commission's conclusions regarding the role of state or local rate setting agencies have the effect of denying standing to LDC's whenever their rate setting agencies intervene in proceedings involving determinations of take-or-pay costs under Order no. 500. They argue that despite a decision by an LDC to accept a pipeline's take-or-pay recovery proposal, a decision by its regulatory body to challenge the pipeline's prudence can expose it to a potentially much larger financial obligation. They request that the Commission order that the results of state or local rate setting agencies' challenges to prudence not be binding on the agencies' regulated companies. The relief sought will not be granted." (Re United Gas Pipeline Co., 45 F.E.R.C. at 62,054, 99 Pub. Utilities Rep. 4th at 344.)

In footnote six of this decision, FERC reaffirmed its position that State regulatory agencies may prevent LDC's from recovering portions of their take-or-pay cots under certain circumstances:

> "See Nantahala Power & Light Co. v. Thornburg, 476 U.S. 953, 74 PUR4th 464, 90 L. Ed. 2d 943, 106 S. Ct. 2349 (1986), in which the Court held that a State may not conclude in setting retail rates that FERC-approved wholesale rates are unreasonable. See also, Kentucky West Virginia Gas Co. v. Pennsylvania Pub. Utility Commission, 92 PUR4th 542, 837 F.2d 600

> (3rd. Cir. 1988). However, as the Commission stated in Order No. 500, it "does not believe that Nantahala precludes state regulators from designing LDC rates, or, in appropriate circumstances, from reviewing the prudence of LDCs' purchasing decisions insofar as they affect take-or-pay costs. *** The development of cost allocation procedures and rates for the LDC's are matters to be determined by state regulatory authorities.' Order No. 500 at 30,790." Re United Gas Pipeline Co., 45 F.E.R.C. at 62,054 n.6, 99 Pub. Utilities Rep. 4th at 346 n.6.

We are not persuaded, by the fact FERC has in most instances allowed pipelines to recover their full take-or-pay costs from their customers, that FERC intended all LDC's be permitted to recover the full amounts of their take-or-pay costs from their rate payers. Different factors obviously affect determination of the questions of whether pipelines, on the one hand, and LDC's, on the other hand, should be permitted full recovery of their take-or-pay costs. Furthermore, the fact LDC's have no present choice but to pay the take-or-pay costs billed to them does not necessarily mean they should be permitted full recovery of these costs. Past actions of the LDC's influenced the amount of these costs. For example, an LDC's choice of a natural gas supplier which subsequently incurred high take-or-pay charges obviously caused that LDC to incur higher take-or-pay costs than it would have incurred had it chosen a supplier which incurred lower take-or-pay. Whether an LDC that chooses a supplier which incurred take-or-pay charges should be denied full recovery of its take-or-pay costs, because of lack of prudence at the time that choice was made, is a question which we do not here decide.

Finally, the fact the ICC conducts annual reviews of fuel costs to determine the prudency of utilities' fuel purchases pursuant to section 9-200 of the Act (Ill. Rev. Stat. 1987, ch. 111 2/3, par. 9-200) does not preclude remandment of this cause to the ICC for further proceedings. The ICC premised its decision solely on the applicability of the Federal preemption doctrine; it did not address the question of the possible redundancy of further prudency hearings in view of prior section 9-200 prudency hearings. It would be inappropriate for us to address this question without the ICC having had a prior opportunity to consider it.

The scope of our decision today is very limited. We merely hold the ICC is not precluded by the Federal preemption and filed-rate doctrines from requiring LDC's to absorb a portion of their take-or-pay costs. We do not consider whether the LDC's should, in fact, absorb any portion of those costs. That is for the ICC to decide in subsequent proceedings. At the proceedings following remandment of this cause, the ICC is to admit evidence pertaining to (a) the sharing of the take-or-pay costs of LDC's between the LDC's and rate payers and (b) the factors relevant to the prudence of the past purchasing practices of the LDC's as they relate to take-or-pay costs. We recognize our decision may cause the ICC to change some of its holdings as to issues other than those which we here address.

The portions of the ICC's July 20, 1988, and November 22, 1988, orders dealing with the applicability of the Federal preemption and filed-rate doctrines, and the exclusion of evidence relevant to the sharing of take-or-pay costs and the prudence of the LDC's past purchasing practices, are reversed. This cause is remanded to the Illinois Commerce Commission for further proceedings in conformity with the views express herein.

Reversed and remanded.

GREEN, J., concurs.

LUND, J., dissents.

JUSTICE LUND, dissenting:

I dissent and would concur with the ICC's finding that it was preempted from considering whether local distribution companies (LDC's) should be allowed to recover from their customers all or part of take-or-pay costs allocated to the LDC's by the rules of the Federal Energy Regulatory Commission (FERC).

First, it should be understood that, pursuant to section 9-200 of the Public Utilities Act (Act) (Ill. Rev. Stat. 1987, ch. 111 2/3, par. 9-200), utilities are required to establish the prudence of purchases on an annual basis. Second, the automatic adjustment clause allowing costs of natural gas to be passed on through to the customers, as an alternative to general rate case filings, has been approved by the Illinois Supreme Court. (See City of Chicago v. Illinois Commerce Commission (1985), 13 Ill. 2d 607, 614, 150 N.E.2d 776, 780.) Third, as pointed out in the majority opinion, take-or-pay terms in contracts became standard during the natural gas shortage in the 1970's. Fourth, when gas became plentiful, local users and LDC's made direct purchases (often using the pipelines of the previous wholesale supplier) at a lower cost than interstate pipelines could charge (at least partly because of their existing take-or-pay contracts).

The FERC stepped in with Order 500, allowing the interstate pipelines to pass on losses incurred because of the take-or-pay contracts. The majority opinion adequately describes Order 500 and its effect.

Order 500, in effect, upholds the take-or-pay clauses and allows for, at least, part of the cost incurred by the clauses to be recovered by adding to the wholesale cost of power. The contracts entered into by the LDC's, which included the take-or-pay clauses, were previously subject to scrutiny under the annual review provisions of section 9-200 of the Act. The prudence review not sought would, in reality, be considering the propriety of the provisions of take-or-pay clauses included in the contracts.

The FERC made the following statement in Re United Gas Pipe Line Co. (1988), 45 F.E.R.C. par. 61, 335, at 62,054, 99 Pub. Utilities Rep. 4th 343, 344-45:

> "LDCs rates are regulated exclusively by state and local rate setting agencies. However, those agencies are preempted from questioning or altering the wholesale rates set by this Commission. Instead, they must allow their regulated LDCs to recover in retail rates the costs incurred as a result of paying the wholesale rates determined by this Commission. Consequently, state and local rate setting agencies take a special role in this Commission's proceedings. That role is recognized in Commission regulations that grant automatic party status to state commissions that file timely notice of intervention. By participating in a pipeline's take-or-pay recovery proceeding under Order No. 500 on the issue of prudence, state and local rate setting agencies are pursuing their only opportunity to examine the reasonableness of the take-or-pay costs of their regulated companies supplier and thereby have some input into the determination by this Commission of the amount of that supplier's take-or-pay costs to be recovered through fixed charges."

It is my opinion that both Nantahala and Mississippi Power support the ICC's conclusion of Federal preemption.

In Nantahala, the North Carolina Supreme Court was reversed when it held the percentage of entitlement power allotted to a North Carolina utility by the FERC could be increased by the State Utilities Commission. Not only was the FERC's exclusive jurisdiction over interstate power recognized (Nantahala, 476 U.S. at 956, 90 L. Ed. 2d at 948, 106 S. Ct. at 2352), but the decision holds the exclusive jurisdiction extended to the allocation of entitlement power. At issue is the "matter of enforcing the Supremacy Clause." Nantahala, 476 U.S. at 964, 90 L. Ed. 2d at 952, 106 S. Ct. at 2355.

> Justice O'Conner wrote, as follows:
>
> "In Chicago & North Western Transp. Co. v. Kalo Brick, 450 U.S. 311, 67 L. Ed. 2d 258, 101 S. Ct. 1124 (1981), the Court similarly noted that the filed rate doctrine as applied to the actions of the Interstate Commerce Commission assisted in the enforcement of the supremacy of federal law:

> > The common rationale of these cases is easily stated: "[T]here can be no divided authority over interstate commerce, and . . . the acts of Congress on that subject are supreme and exclusive." Missouri Pacific R. Co. v. Stround, 267 U.S. 404, 408 [69 L. Ed. 683, 685, 45 S. Ct. 243, 245] (1925). Consequently, state efforts to regulate commerce must fall when they conflict with or interfere with federal authority over the same activity. Id., at 318-319, 67 L. Ed. 2d 258, 101 S. Ct. 1124."
>
> (Nantahala, 476 U.S. at 964, 90 L. Ed. 2d at 953, 106 S. Ct. at 2355-56.)

She went on to state:

> "In both contexts, these courts have concluded that a state utility commission setting retail prices must allow, as reasonable operating expenses, costs incurred as a result of paying a FERC-determined wholesale price." Nantahala, 476 U.S. at 965, 90 L. Ed. 2d at 953, 106 S. Ct. at 2356.

In Mississippi Power, the FERC has allocated costs of a nuclear power plant among four different operating companies owned by the holding company, which also constructed the nuclear plant. The State of Mississippi attempted to challenge the allocation assigned to Mississippi Power and

Light Company, an intrastate utility. The Supreme Court, citing Nantahala, held that the FERC Federal action preempted State interference. Justice Stevens made the following statement:

> "In this case as in Nantahala we hold that a state utility commission setting retail prices must allow, as reasonable operating expenses, costs incurred as a result of paying a FERC-determined wholesale price . . . Once FERC sets such a rate, a State may not conclude in setting retail rates that the FERC-approved wholesale rates are unreasonable. A state must rather give effect to Congress desire to give FERC plenary authority over interstate wholesale rates, and to ensure that the State do not interfere with this authority. Nantahala, 476 U.S. at 965, 966, 90 L. Ed. 2d 943, 106 S. Ct. 2349." (Emphasis added.) Mississippi Power, 487 U.S. at , 101 L. Ed. 2d at 339, 106 S. Ct. at 2440.

In our present case, the FERC has determined that take-or-pay costs, incurred by interstate power suppliers, shall be passed on to LDC's. The take-or-pay costs have, thus, been determined to be part of the wholesale cost of power by the FERC, and must be allowed by the State utility commissioners as reasonable operating expenses when setting retail prices. I conclude that the ICC does not have the authority to consider the prudence of LDC's prior commitments to take-or-pay costs.

ILLINOIS COMMERCE COMMISSION
INTERIM ORDER
[JULY 20, 1988]

STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

Illinois Commerce Commission On Its Own Motion	:	
Investigation into the appropriate recovery by Illinois gas utilities of costs associated with take-or-pay charges from interstate pipeline companies.	:	88-0103

INTERIM ORDER

By the Commission:

On April 27, 1988, the Commission initiated an investigation into "the appropriate recovery by Illinois gas utilities of costs associated with take-or-pay charges from interstate pipeline companies". The order initiating the investigation directed that all Illinois gas utilities be made parties to the investigation. A staff report to the Commission dated April 16, 1988 ("Staff Report"), relating to the subject matter of the investigation was provided to the aforementioned gas utilities.

Pursuant to notice as required by law and the rules and regulations of the

Commission, this matter came on for prehearing conference before a duly authorized Hearing Examiner at the Commission's offices in Chicago, Illinois, on May 31, 1988. Counsel appeared on behalf of the Office of Public Counsel ("OPC"), The Peoples Gas and Light Company ("Peoples"), North Shore Gas Company ("North Shore"), Illinois Power Company ("IP"), Central Illinois Light Company ("CILCO"), Union Electric Company ("UE"), Interstate Power Company ("Interstate"), Northern Illinois Gas Company ("NI-Gas"), Iowa-Illinois Gas and Electric Company ("Iowa-Illinois"), Central Illinois Public Service Company ("CIPS"), United Cities Gas Company ("United Cities"), certain large industrial customers collectively referred to as Illinois Industrial Energy Consumers ("IIEC"), Monarch Gas Company, the State's Attorney of Cook County, Tennessee Gas Pipeline Company ("Tennessee") and Steven Revethis and Ana Cusack-Marcyan, Special Assistants Attorney General on behalf of the Staff of the Commission.

At the prehearing conference, Petitions to Intervene filed by IIEC and Tennessee were granted by the Hearing Examiner. A discussion took place regarding the appropriate scope of the proceeding. The decision ultimately was made that parties could brief this issue. Initial briefs were filed by Peoples and North Shore, IP, CILCO, UE, NI-Gas, Interstate, United Cities, OPC and IIEC. Iowa-Illinois adopted the initial brief of NI-Gas in lieu of filing its own brief. Reply briefs were filed by Peoples and North Shore, IIEC, OPC, UE, NI-Gas, IP and United Cities. Mt. Carmel Public Utility Co. ("Mt. Carmel") adopted the initial and reply briefs of IP in lieu of filing its own briefs. In their briefs, the parties identified three issues that need to be explored. Those issues can be stated as follows:

1. Is the Commission required, as a matter of law, to allow gas utilities subject to its jurisdiction to recover pipeline take-or-pay costs billed under the so-called direct-billing mechanism authorized by FERC Order No. 500?

2. Would such costs appropriately be recovered through the Uniform Gas Charge?

3. Should these costs be recovered through rates applicable to all of the utility's customers or, if not, which classifications of customers should receive these charges?

For the purposes of this Interim Order, the Commission will only discuss the first issue. Simply stated, the issue to be determined is whether the Illinois local gas distribution companies ("LDCs") may be required by this Commission to absorb a portion of the take-or-pay costs billed to them.

A copy of the Hearing Examiner's Proposed Order was served by the Chief Clerk's Office on all interested parties. Briefs on Exceptions were filed by OPC, IIEC, Peoples and North Shore, NI-Gas, CIPS, Mt. Carmel, and Staff. United Cities joined in the Brief on Exceptions filed by Peoples and North Shore. The exceptions were filed in a timely manner. IIEC, OPC, IP, Peoples and North Shore , CIPS and NI-Gas filed timely

Reply Briefs on Exceptions which have been considered herein.

The utilities filing Briefs on Exceptions generally supported the Hearing Examiner's Proposed Order. However, they pointed out that on June 24, 1988, subsequent to the issuance of the Proposed Order, the United States Supreme Court issued its decision in Mississippi Power & Light Co. v. Mississippi, 48 CCH S.Ct., Bull. B 3308, in which the Supreme Court precluded state commissions from reviewing the prudency of past take-or-pay costs allocated by FERC to LDCs. This Interim Order may properly reflect the Mississippi Power & Light decision.

OPC and IIEC did not cite the Mississippi Power & Light decision in their initial Briefs on Exceptions. IIEC in its exceptions contends that the Commission should not rule out the possibility of voluntary absorptions of take-or-pay costs by the LDCs at this point in the proceeding.

IIEC's other exceptions supported its briefs relating to advocating a review of an individual utility's prudency as well as offsetting take-or-pay costs, with potential expense reductions. IIEC's Reply Brief on Exceptions sought to distinguish the Mississippi Power & Light case from this proceeding. IIEC contended that take-or-pay costs are not equivalent to paying a FERC determined wholesale rate for a FERC mandated allocation of power. IIEC alleged that this Commission, not FERC, has jurisdiction to determine the prudency of gas purchases by a LDC. IIEC also alleged that the Commission has jurisdiction to determine if a LDC could have prudently avoided or minimized its liability for take-or-pay costs. IIEC further alleged that the Mississippi Power & Light decision did not address any potential offsetting reductions in unrelated expenses which might deny LDC's dollar-for-dollar recovery of such take-or-pay costs. The Commission's review of the Mississippi Power

& Light decision leads to the conclusion, as stated several times throughout this Interim Order, that the Supreme Court has precluded this Commission from reviewing the prudency of past take-or-pay costs allocated by FERC to LDCs. The Commission agrees with IIEC that potential offsetting factors may impact a dollar-for-dollar pass through of take-or-pay costs.

OPC's Initial Brief on Exceptions reflects positions taken in its previously filed briefs and are subsequently discussed herein. In its Reply Brief, OPC contends that LDCs had a legal right to avoid their take-or-pay cost liability by refusing to purchase the power. OPC then contends that this Commission could review these discretionary power purchases, citing the Mississippi Power & Light decision, Bull. 3328. The Commission is aware that FERC allocated past take-or-pay costs are direct billed to LDCs and OPC has not suggested how LDCs may avoid the payment of any portion of these costs. These costs are not subject to the Commission's prudency review.

Staff's Brief on Exceptions also failed to cite the Mississippi Power & Light decision regarding the prudency issue. Staff supported IIEC's contention that this Commission, in its final Order, should review potential offsetting factors to a full pass-through of take-or-pay costs. Such offsetting factors should be considered to the extent that they could be properly reflected in the ultimate gas costs passed on to LDC customers.

BACKGROUND

Virtually all Illinois gas utilities are now being billed or will soon be billed by their pipeline suppliers charges related to the pipelines' costs of terminating or reducing take-or-pay obligations under long-term gas supply contracts with producers. In its Order No. 500, issued on August 7, 1987 in Docket No. RM87-34, the Federal Energy

Regulatory Commission ("FERC") established two mechanisms for interstate pipelines to pass through such costs. Pipelines are uniformly opting for the second mechanism allowed by Order No. 500; namely, "direct"-billing of take-or-pay costs through demand-type fixed charges. Order No. 500 describes that method as follows:

> * * * if a pipeline is willing to absorb some of its take-or-pay buyout and buydown costs (anywhere from 25 percent to 50 percent), then it will be permitted to recover an equal amount from its customers through a fixed take-or-pay charge. Additional amounts, up to 50 percent of the pipeline's total buydown or buyout costs, may be billed through a commodity surcharge, or a volumetric surcharge on pipeline throughput.

FERC has rationalized this fixed payment approach as a transitional device justified by the agency's dramatic changes in pipeline regulation in recent years, primarily the "open-access" transportation regulations of Order Nos. 436 and 500.

DISCUSSION

All parties filing briefs agree and the law appears well settled that the Illinois Commerce Commission, in setting retail rates for a local distributor of gas, may not prohibit the recovery in utility rates of the costs of acquiring gas supply paid pursuant to FERC-approved rates. The doctrine, known as the "filed rate" doctrine, is a rule of preemption under which states must give effect to wholesale rates on file with or approved by FERC. Narragansett Elec. Co. v. Burke, 119 R.I. 559, 381 A 2d 1358 (1977); Nantahala Power and Light Company v. Thornburg, 90 L.Ed. 2d 943 (1986); Arkansas Louisiana Gas Company v. Hall, 69 L.Ed. 2d 856 (1981); City of Chicago v. Illinois Commerce Commission, 13 Ill. 2d 607 (1958). Mississippi Power & Light Co. v. Mississippi, 48 CCH S.Ct., Bull. B 3308.

The federal statute which delegates this preemptive authority to the FERC is the Natural Gas Act ("NGA"). 15 U.S.C. Sec. 717

_et_ _seq_. The NGA provides plenary power to the FERC within the statutory authorization to regulate the transportation and sale for resale of natural gas moving in interstate commerce, including the power to regulate interstate natural gas prices. The case of _Pike County Light and Power Co. v. Pennsylvania Pub. Util. Comm's._ 77 Pa. Comm.. 268, 465 A 2d 735 (1983), provides that notwithstanding the rule of federal preemption, a state commission may disallow the cost of power purchased under a FERC approved rate, provided the state commission, through a prudence review, finds that the utility acted imprudently in purchasing the power subject to the FERC approved rate rather than choosing less costly alternatives. However, the _Mississippi Power & Light_ decision precludes state regulatory agencies from disallowing recovery of direct billed FERC-allocated past take-or-pay costs in retail rates, and precludes such agencies from conducting prudence reviews relating to such costs.

IIEC also contends that there may be potential offsetting factors so that full reflection of take-or-pay charges in all Illinois utilities' rates might not be required. This is a truism which the Commission and the parties should all recognize. However, this issue is not relevant to the issue to be determined in this Interim Order. IIEC next contends that the Commission may look for offsetting reductions in utilities' non-gas costs before permitting the reflection of take-or-pay charges in rates. However, this suggestion is fundamentally contrary to established Illinois ratemaking principles and need not be examined in this proceeding. Gas supply costs are not reviewed in conjunction with non-gas costs, for good reasons. Supply costs are separately considered, annually, in reconciliation proceedings.

OPC and IIEC contend that the Commission may prohibit utility recovery of a portion of the pipeline take-or-pay costs because they believe the FERC has indicated that it does not intend to preempt such action. These parties contend that the filed rate doctrine does not apply to these costs, by virtue of the intervening legal effect of FERC's purported intent.

In the Commission's view, OPC and IIEC have given an overly broad meaning to what the FERC said in its Order No. 500. While the FERC may in the abstract favor absorption of a portion of the take-or-pay costs by every segment of the natural gas industry, it did not declare that states had the power to force LDCs to absorb any costs, nor that it was authorizing the states to do so. The FERC merely acknowledged that it has no control under the NGA over the design of retail rates -- an issue of allocation among ratepayers -- and that states may review the issue of prudency. As previously noted, a prudence review is precluded under the circumstances of this proceeding by the Mississippi Power & Light decision and so

FERC could not require or authorize such a prudence review by state agencies.

The Commission concludes that the filed rate doctrine should be applied in this investigation proceeding and this doctrine requires that the Commission permit the recovery of all take-or-pay costs incurred through FERC-approved direct-billed rates. Mississippi Power & Light Co. v. Mississippi, 48 CHH S.Ct. Bull. at B3308 (June 24, 1988), Nantahala Power and Light Co. v. Thornburg, 476 U.S. 953 (1986); City of Chicago v. Illinois Commerce Commission, 13 Ill. 2d 607 (1958). The Commission's reading of Order No. 500, in view of Mississippi Power & Light, is that FERC did not expressly intend that recovery be partially disallowed by state regulators. The Commission should not require LDCs to absorb a portion of the take-or-pay costs billed properly to them.

A fully evidentiary record should be made on the two remaining issues presented in this investigation proceeding, as identified on Page 2 of this Interim Order, except any offsetting expense factors as argued by IIEC.

The Commission, having given due consideration to the record herein and being fully advised in the premises, is of the opinion and finds that:

(1) by Order entered on April 27, 1988, this Commission initiated an investigation to determine the appropriate recovery of costs incurred by Illinois gas utilities pursuant to FERC Order No. 500;

(2) all gas utilities subject to the jurisdiction of the Commission were made parties to the investigation;

(3) the Commission has jurisdiction over the parties and of the subject matter hereof;

(4) the recitals of fact and the conclusions reached in the prefatory portion of this order are supported by the record and are hereby adopted as findings of fact;

(5) this Commission may not prohibit a local distributor from recovering direct billed past take-or-pay costs allocated to it under rate schedules filed with and approved by the FERC; such action by a state is preempted by the FERC's statutorily-mandated federal oversight of wholesale natural gas rates; LDCs need not absorb a portion of the take-or-pay costs properly allocated to them by the FERC;

(6) the potential offsetting factors to take-or-pay charges, including reductions in utilities' non-gas costs, need not be the subjects of evidentiary presentations by the parties;

(7) the two remaining issues set forth on Page 2 of this Interim Order are properly the subject of this investigation proceeding;

(8) the scope of this investigation proceeding is limited as set forth in Findings (5), (6) and (7).

IT IS THEREFORE ORDERED that the investigation proceeding is limited in accordance with Findings (5), (6) and (7) herein.

By order of the Commission this 20th day of July 1988.

(SIGNED) MARY B. BUSHNELL

Chairman

(S E A L)

Commissioner Kretschmer dissents.

ILLINOIS COMMERCE COMMISSION
FINAL ORDER
[November 22, 1988]

STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

Illinois Commerce Commission On Its Own Motion – Investigation into the appropriate recovery by Illinois gas utilities of costs associated with take-or-pay charges from interstate pipeline companies.	)	88-0103

ORDER

By the Commission:

On April 27, 1988, the Commission initiated an investigation into "the appropriate recovery by Illinois gas utilities of costs associated with take-or-pay charges from interstate pipeline companies". The Order initiating the investigation directed that all Illinois gas utilities be made parties to the investigation. A Staff Report to the Commission dated April 26, 1988 relating to the subject matter of the investigation was provided to the aforementioned gas utilities.

Pursuant to notice as required by law and the rules and regulations of the Commission, this matter came on for prehearing conference before a duly authorized Hearing Examiner at the Commission's offices in Chicago, Illinois, on May 31, 1988. Counsel appeared on behalf of the following gas utilities: The Peoples Gas and Light Company ("Peoples"), North Shore Gas Company ("North Shore"), Illinois Power Company ("IP"), Central Interstate Power Company ("Interstate"), Northern Illinois Gas Company ("NI-Gas"), Iowa-Illinois Gas and Electric Company ("Iowa-Illinois"), Central Illinois Public Service Company ("CIPS"), United Cities Gas Company ("United Cities"), Mt. Carmel Public Utility Company ("Mt. Carmel"), and Monarch Gas Company ("Monarch"). Counsel also appeared on behalf of the Office of Public Counsel ("OPC"), which filed a Notice of Intervention, certain large industrial customers collectively referred to as Illinois Industrial Energy Consumers ("IIEC"), Tennessee Gas Pipeline Company ("Tennessee"), Steven Revethis, Ana Cusack-Marcyan and David Nixon, Special Assistants

Attorney General represented the Staff of the Commission. Subsequent hearings were held on July 25, 26, 27 and 28, August 3, 4, 25 and 26, 1988.

Petitions to Intervene filed by IIEC, Midwestern Gas Transmission Company substituting for Tennessee, Phoenix Chemical Company and the Attorney General on behalf of The People of the State of Illinois ("Attorney General") were granted by the Hearing Examiner. At the conclusion of the hearing on August 26, 1988, the record was marked "Heard and Taken."

Only July 20, 1988, the Commission entered an Interim Order which allows Illinois local gas distribution companies ("LDCs") to pass through 100% of the direct billed past take-or-pay ("TOP") costs properly allocated to them by the Federal Energy Regulatory Commission ("FERC"). As a result of the Interim Order, only two issues remain to be resolved: 1) The recovery mechanism for TOP costs; and 2) the customer classes paying TOP costs.

The following provided direct and rebuttal testimony during these proceedings: John A. Lawrisuk, Vice President of Regulatory Affairs, and Gas Supply Acquisition and Charles M. Blachut, Superintendent, Gas Supply Planning for Peoples and North Shore; Norbert G. Oliver, Managing Director of Rates for NI-Gas; Alan Rosenberg, Drazen, Brubaker and Associates for IIEC; Richard M. Thomas, Manager of Gas Resources for IP; Jon R. Carls, Fuel and Job Order Accounting Supervisor for CIPS; Glenn B. Rogers, Senior Vice President-Gas Supply, Marketing and Rates for United Cities; Deborah R. Kennedy, Supervisor - Gas Supply Unit for CILCO; David H. Berentsen, Assistant Director of Rates, and Ray P. Richards, Director of Gas Operations for Interstate; Constance Tripp, Senior Economist, Policy Analyst, Rate Design Department, and Steven R. Kenpler, Accounting Department for Staff.

The following provide direct testimony only: Maurice E. Halsey, Vice President, and

L. Raymond Billett, Assistant Vice President Supply Administration for NI-Gas; C. J. Zemaitis, Supervisor - Rate Administration, and Denean V. Smith, Director of Accounting Services for IP; Dale M. Richeson, Director of Rates for Iowa-Illinois; Dale L. Cinotto, Administrative Supervisor - Gas Department for CIPS; Mark H. Pappas, Engineer in Rate Engineering Department for UE; Charles Lowe, Chief Executive Officer for Monarch; C. P. Huddleston, Superintendent of Operations for Illinois Gas Company; and J. Richard Hornby, Manager of Natural Gas Projects, Energy Systems Research Group, for OPC.

Initial Briefs were due on September 26, 1988 and the following parties filed Briefs: OPC, Attorney General, IIEC, IP, UE, Interstate, Mt. Carmel, Iowa-Illinois, CIPS, CILCO, United Cities, NI-Gas, Peoples and North Shore, and Staff.

Reply briefs were due on October 12, 1988 and the following parties filed Reply Briefs: OPC, Attorney General, IIEC, Staff, Interstate, Iowa-Illinois, IP, NI-Gas, CILCO, Peoples and North Shore. IIEC, OPC and IP have made written requests for oral argument for the Commission.

A copy of the Hearing Examiner's Proposed Order was served on the parties. The following parties filed Briefs on Exceptions: OPC; Attorney General; IIEC; IP; Peoples and North Shore; NI-Gas, Iowa-Illinois; CILCO; and Staff.

Briefs on Exceptions filed by Iowa-Illinois, CILCO, Peoples and North Shore, NI-Gas and Staff were designed to correct and clarify certain portions of the Proposed Order. Most of the exceptions have been incorporated into the Order. The Initial brief on Exceptions filed by the Attorney General is limited to the issue of bypass. The Attorney General requests that no anti-bypass tariffs be approved by the Commission. The Commission does not agree with the Attorney General's position.

Replies to briefs on exceptions were filed by the following parties: IIEC; OPC; Iowa-Illinois; Peoples and North Shore; NI-Gas; IP; and Staff.

OPC filed extensive exceptions which may be described as specific, clarifying and re-argument of positions taken in the course of these proceedings. The specific exceptions have been incorporated into the Order. Some exceptions dealing with OPC's position regarding bypass tariffs and a recognition of OPC's acceptance of the uniform volumetric allocation methodology have been incorporated in the Order. Most of OPC's exceptions deal with overturning of Interim Order. After reviewing the cases cited in the Interim Order and FERC Order No. 500, OPC concludes that this Commission should review LDCs prudency and have LDCs share in TOP costs: The Interim Order does not require LDCs to share, or absorb TOP costs. This Commission reaffirms the Interim Order. LDCs have passed on to its customers the savings from spot gas purchases.

All customers have benefitted from current low gas costs. Other than a gratuitous comment by FERC in Order No. 500, no good reason has been advanced to require LDCs to share in the TOP liability. Other exceptions filed by OPC have not been adopted in the Order.

IP's exceptions clarified its position regarding the Rider H proposal. Some clarification has been made part of the Order. IP requests that the Commission rule on whether its lump sum payment proposal should be approved. As stated subsequently, the Commission does not believe it has sufficient information in the record to approve Rider H. The lump sum payment provision is rejected. IP should amend Rider H accordingly.

IIEC filed numerous exceptions to the Proposed Order. IIEC provided a more detailed explanation of its positions on the issues in this proceeding. The Order incorporates IIEC's explanation of its opposition to the Staff's position. No other exceptions are adopted. IIEC took exception to such findings which affirmed the Interim Order, the rejection of IIEC's alternative recovery mechanism for TOP costs, the acceptance of the UPGA as the primary recovery mechanism for TOP costs, the collection of TOP costs from transportation customers, and the failure to accept dual fuel users as an exception to the collection of TOP costs. These exceptions are dealt with in the Order and the bases for contrary conclusions need not be specified. IIEC has not provided any additional arguments which cause the Commission to alter the conclusions set forth in the Proposed Order.

Background

Before reviewing the issues presented in this matter, some background of the TOP liability is necessary. TOP costs generally refer to the costs which a pipeline has incurred in conjunction with its historical or past gas purchase obligations. In this docket, the Commission is dealing with pipeline costs incurred both to settle past TOP claims, either buyout or buydown, and to achieve prospective contract reformation. On April 29, 1988, in Docket No. 88-84, the FERC approved a cost recovery plan for Natural Gas Pipeline Company of America under which settlement costs would include amounts paid or committed to be paid through December 31, 1988. In the event FERC extends that date beyond December 31, 1988, the Commission would also consider those cost obligations to be recoverable in this proceeding.

It is generally agreed that when pipelines were no longer able to maintain historical levels of gas purchases in order to avoid the TOP liability as specified in their contracts with producers the TOP problem developed. Four historical events seemed to have caused the TOP problem. First, there was a gas shortage in the 1970's. Second, due to the gas shortage, pipelines contracted for substantial volumes of new gas from producers. Third, under the Natural Gas Policy Act of 1978, gas prices were regulated at higher levels. Fourth, a "gas bubble" or surplus developed giving rise to the spot gas market which took sales away from interstate pipelines. Added to these historical events are such factors as conservation, warmer weather, fuel switching to oil, and end-user open access transportation of their own gas supplies. These events and factors reduced the pipelines need for long-term gas supplies under contract with producers and were principally responsible for the TOP problem.

Presentation of Issues

A. Staff Position

Except as hereinafter noted, LDCs have generally supported Staff's position in this docket. OPC, the Attorney General and IIEC have generally opposed Staff's positions. Accordingly, an appropriate starting point for examining the remaining issues to be resolved herein is an analysis of the Staff's presentation.

Staff generally contends the 1) the Uniform Purchased Gas Adjustment Clause ("UPGA") is the appropriate mechanism to recover TOP costs; 2) direct-billed TOP charges should be passed through to sales and transportation customers on a uniform volumetric basis except those customers on a rate designed to prevent bypass of the LDC's distribution system with a direct connection to an interstate pipeline; TOP charges not direct-billed should be paid by end-users using the services; and, 3) with the exception noted in 2), current UPGA clause tariffs should be modified to pass through TOP charges to all classes of customers. It should be noted that under the Staff proposals only customers that use pipeline gas having TOP in commodity rates or customers that use gas transported over a pipeline with a volumetric surcharge would be assessed TOP charges that are not direct-billed by a pipeline.

Staff contended that one of the purposes of this docket was to establish a generic proceeding to allow most LDCs to expeditiously recover their TOP charges. Several LDCs supported this Staff position. While most

LDCs supported the concept of recovery of TOP charges through the UPGA, several LDCs, such as IP and CIPS, recommended that a separate rider be established. CIPS' proposal would mirror the UPGA and recovers TOP costs from transportation customers. OPC and IIEC also suggested that a separate generic rider be established.

Staff contended that TOP costs are gas cost recoverable through the UPGA Gas Charge and Adjustments, 83 Ill. Adm. Code 525.10. Section 525.10(b) defines gas costs, as follows:

> "1) any solid, liquid or gaseous hydrocarbons purchased for injection into the gas system purchased as feed-stock or fuel for the manufacture of gas or delivered to the company under an exchange agreements."

The Staff testimony, particularly by Mr. Corbin, and supported by most LDCs, contended that past TOP costs billed to LDCs are part of the cost of gas purchased by those same LDCs for injection into the load distribution network. As such, they are no different than the gas supply costs recovered through the UPGA and the UPGA recovery is consistent with Commission policy to segregate distributors' gas costs from their base rates. (Staff Ex. RD 1.0, p. 3).

While Staff preferred the UPGA mechanism to recover TOP liability, it was not adverse to other riders or surcharge mechanisms which might properly recover TOP costs. Staff contended that when a specific rider is presented it should contain a 10% interest rate to be used in the computation of interest charges and that the interest determination period correspond to the recovery period. Also, Staff proposed that an LDC TOP rider address the treatment of the ending TOP balance. Staff recommended that each LDC report details of its direct-billed TOP costs, collections and unrecovered balance monthly along with the LDC's monthly UPGA filing. The LDC would also file reports annually along with the annual UPGA reconciliation proceeding and at the end of the TOP recovery period. Staff recommended that the TOP costs and recovery of same be subject to audit and that the LDCs have the burden of proof with respect to the TOP cost figures and their recovery. Staff further recommended that whether an LDC uses the UPGA mechanism, or a separate rider, each LDC should file its recovery mechanism proposal within forty-five days of entry of this Order.

If a UPGA alternative rider is proposed, Staff suggested that an LDC should describe A) Why the PGA mechanism is inappropriate; and, B) Why the alternative proposal is preferable. The LDC should be prepared to discuss the following: 1) The low cost implementation off the rider; 2) Timely recovery of TOP costs; 3) How the rider fits the recovery cycle; 4) How changes in base rates would be avoided; 5) How numerous additional filings would be avoided; 6) The rider should contain an annual reconciliation proceeding; and 7) How the rider will recover

TOP costs from appropriate rate classes.

IIEC has opposed the Staff position regarding the use of the UPGA for recovery of TOP costs on several grounds. First, the subject TOP costs do not represent the cost of gas purchased in the past, gas purchased on a current basis, or gas to be purchased in the future. Second, the payment of the TOP costs do not result in the acquisition of any additional service from the pipelines, nor do they entitle LDC's to demand additional gas supply. Third, the costs in question are one-time, nonrecurring costs and not appropriate for recovery in the UPGA.

IIEC has opposed the Staff position regarding the recovery of TOP costs on a uniform volumetric basis for three (3) basic reasons: (1) collection of TOP costs from sales and transportation customers on a uniform volumetric basis fails to maintain current cost relationships; (2) collection of TOP costs on a uniform volumetric basis is inconsistent with marginal costs pricing principles in that it signals customers that the utilities' costs will change each time an additional MCF of gas is purchased by that customer when the costs in question are fixed, one-time, nonrecurring costs; (3) collection on a volumetric basis sends a signal to large volume, high-load factor customers that their current usage has imposed an additional cost on the system and they should reduce their usage in order to minimize the cost, when in fact, reduced usage will not minimize the cost and will, in fact, increase the cost to those ratepayers who cannot reduce their usage significantly or switch to alternate fuels or by-pass the system.

IIEC also opposed the allocation of take-or-pay costs to transportation customers for reasons discussed in Part D below.

B. IP's Position

The LDC with the greatest problem in passing TOP charges through the UPGA is IP. IP claimed that it cannot use the UPGA to recover TOP costs. Currently, IP recovers gas costs by means of Rider A for residential service and Rider B for industrial service. In addition, transportation customers are charged under Rider W. IP alleged that Riders A and B require separate calculations of charges and are not applied in the same manner to recover gas charges. If TOP costs are passed through as a demand component of Riders A and B, interruptible customers would not pay any share of the TOP costs. Accordingly, IP proposed a new rider. Rider H, to recover TOP costs from all its customers.

IP also claimed that there would be an inequitable shifting of costs if its Riders A and B would be used to collect TOP charges. Moreover, modifications to these riders would be more complex and expensive. IP alleged that under Rider H, which IP represented would prevent uneconomic bypass, customers would pay their fair share of costs and would allow IP to spread TOP charges over a larger number of customers. Specifically, Rider H would require customers leaving the IP system to make a lump sum payment equal to the present value of the total TOP surcharges. The actual gas usage for period of July 1, 1987 through June 30, 1988 would be used to estimate a particular customer's payment. IP would not assess the payment to those customers having dual-fuel capability or those customers who leave IP's service territory. IP contended that pursuant to Section 9-101 of The Public Utilities Act, the Commission may approve Rider H as a "just and reasonable" rate. IP also pointed to the United Gas Pipeline Company decision of December 31, 1987, Docket No. RP88-27-000, in which FERC approved a lump sum payment of TOP charges from customers leaving the United Gas system.

Staff and IIEC objected to the IP lump sum payment proposal. They share the concern that such a proposal would create an unsettling precedent in Illinois. IIEC contended that industrials could leave the IP system before the lump sum payment became effective and after a customer left the system there would be no effective way to collect the amount owed. Staff opined that such a fee could be extended to any customer leaving the system. Rather than being a bypass disincentive, Rider H might cause customers to shift plant operations to other facilities outside IP's service territory. Further, Staff contended that IP has not presented any proof that the presence of this lump sum payment would be a major deterrent to a customer leaving the system. Staff also alleged that since the recovery of TOP charges are relatively short-term by their nature, the TOP costs charges alone would not cause a customer to bypass IP's system. In essence, Staff concluded that a lump sum payment would not enable IP to assuredly recover TOP costs from the appropriate customer classes.

C. OPC's Position

OPC contended that TOP costs are non-purchased gas costs which FERC would not allow to be direct-billed through the UPGA. Thus, OPC recommended that TOP costs be recovered through a separate rider which would operate in the same manner as recovery through base rates. OPC's proposed separate rider would allocate TOP costs to an LDC's customers based upon their relative responsibility for such costs. OPC's position may be summarized, as follows: 1) LDCs should have a reasonable opportunity to recover prudently incurred costs; 2) costs recovery should be based on cost causation; and 3) all customers should bear these transition costs. However, in its initial and reply Briefs, OPC acknowledged that TOP costs should be recovered on a uniform volumetric basis.

Under OPC's original proposal, and LDC would identify the system supply deficiency, general reduction deficiency and the transportation deficiency. An allocation of TOP costs would be made between sales and transportation based upon the volume of services provided each class of customers with credits given for interstate pipeline charges. A cap would be placed on the revenues recoverable based upon a market test component. That is, an LDC in reacting to market pressures and competition may not pass 100% of the TOP charges to its customers, preventing an overrecovery. OPC supported the recovery of TOP costs on a volumetric basis. OPC's witness, Mr. Hornby, then allocated NI-Gas' deficiency to sales and transportation customers. (OPC Exhibit 1, page 55 et seq.) OPC attributed a lesser liability to transportation customers. While OPC's witness Mr. Hornby attempted to assign allocations of an LDC's TOP deficiency among sales and transportation customers, he acknowledged that the Commission might modify his allocation formula to account for various factors which he ignored (TR. 114-118).

OPC has requested that the Commission not issue an Order which 1) defines TOP charges as gas costs recoverable under UPGA; and 2) allows TOP costs charged to end-users taking under anti-bypass rates to be allocated to existing customers. OPC has also requested that this Order be entered on an interim basis pending further FERC decisions in Order Nos. 436 and 500. If any FERC action or subsequent court decisions affect this Order and is brought to the attention of the Commission, appropriate action will be taken by the Commission.

The Attorney General fully supported the testimony presented by Mr. Hornby. Despite the fact that OPC amended its position, the Attorney General continued to contend that TOP costs should not be recovered on the basis proposed by Mr. Hornby. The Attorney General equated TOP costs with penalty charges specifically excluded by 3 Ill. Adm. Code 525.10(b)(1)(C).

LDCs and Staff criticized the OPC proposal. LDCs generally contended that the OPC method was less efficient and cost effective; more complex, requiring changes in billing formats and procedures; does not distinguish between past settlement costs and future contract reformations; is incomplete, because it does not account for release gas; creates a bias in favor of sales customers; does not allow full recovery of TOP costs in accordance with the Interim Order in this docket; and, may create an artificial incentive for customers to switch from transportation to sales service. IIEC, the LDCs and Staff have maintained that it is impossible to ascertain the relative responsibility of customer classes for TOP costs. These parties contended that TOP costs are not susceptible to being classified or allocated either on an embedded or marginal costs basis.

D. IIEC's Position

IIEC contended that transportation customers should not be assessed TOP costs. IIEC argued that: 1) if LDCs are excused, the Commission should also excuse transportation customers; 2) an allocation of TOP costs may cause a loss of throughput; 3) transportation customers cannot be assigned TOP costs either on a cost causation or benefit basis; 4) transportation customers do not purchase LDC system supply; 5) FERC has refused to permit collection of TOP costs from transportation customer sunder its jurisdiction; for example, the Court of Appeals has affirmed that TOP costs are prepaid assets and not gas costs in the case of Diamond Shamrock Exploration Co. v. Hodel, 853 F. 2d 1159 (5th Cir. 1988); and 6) exempting transportation customers would not materially harm sales customers.

As an alternative, IIEC proposed that a separate rider be established to recover TOP costs from sales and transportation customer on a uniform percentage of revenue basis. Under this proposal, recovery of TOP costs would be limited to 1% of an LDC's annual total revenues, except where a larger recovery may be justified based on an LDC's financial condition. An LDC would be permitted to seek traditional ratemaking treatment for that portion of the TOP which are deferred for later recovery. IIEC contended that the proposed 1% surcharge would recover TOP costs over a six to eight year period mitigating the effect on customers. IIEC also contended that the proposed surcharge sends better pricing signals to customers than the UPGA and is in accord with marginal cost pricing principles.

LDCs and Staff found five bases to oppose IIEC's proposal. First, they claimed that surcharge mechanism is less efficient and cost effective than the UPGA because it duplicates UPGA tracking mechanisms and might require changes in filing formats and procedures. IIEC's proposed generic rider might, in effect, lack the flexibility to apply to the individual circumstances of each LDC. Second, since TOP costs are gas costs, the proper recovery mechanism is the UPGA. Past Commission practices support the use of a uniform volumetric approach to recover analogous charges, such as unaccounted for gas costs. Third, the IIEC recovery mechanism is inequitable. Under the IIEC proposal, transportation customers would pay lower TOP surcharges than comparable sales customers. Using NI-Gas as an example, an average industrial sales customer would pay a TOP surcharge of .76 cents per therm, while a transportation customer using the same volume of gas would pay a TOP surcharge of .13 cents per therm (NI-Gas. D, p. 2, and Ex. NGO-6). Fourth, IIEC's proposal might cause sales customers to switch to transportation, thereby causing an even greater amount of TOP costs to be allocated to remaining sales customers. Finally, those in opposition contended that IIEC has failed to present any evidence to support the 1% annual recovery limitation.

E. Bypass and Other LDC Proposals

IP's Rider H proposal was not the only method proposed by LDCs to combat the possibility of bypass. CILCO's Rate 10 and NI-Gas' Rate 17 offer customers individual cost-based rates. Customers taking under these rates would be exempt from paying TOP costs. CILCO and NI-Gas contended that the revenues collected from the customers taking service under these rates would retain these customers on the LDC's system and allow recovery of fixed costs from a larger group of customers. The result is a lower recovery of fixed costs from other customers. Rates 10 and 17 have already been implemented by CILCO and NI-Gas, respectively. Staff fully supported these rates. Ms. Tripp explained that in the interim period between the time a customer took service under an anti-bypass rate and the time an LDC filed a rate case, the LDC would receive lower revenues and share in the costs (TR. 1324).

Iowa-Illinois has proposed a deficiency allocation methodology to recover TOP costs under the UPGA. Iowa-Illinois would allocate TOP charges based upon a customer's use and/or purchase of non-pipeline gas during the period when such deficiencies were created so as to match the benefits of low-cost spot market purchases to the resulting TOP costs. Iowa-Illinois would assign the TOP costs either as system supply or transportation costs, and allocate them further between the states of Iowa and Illinois. No party objected to this deficiency allocation methodology.

NI-Gas has proposed an exception to the use of a UPGA recovery mechanism. NI-Gas, in addition to its Rider 17 approach, proposed that an exchange agreement with Mobil Oil Company ("Mobil") and a transportation contract with CIPS be exempted from the assessment of TOP liability. NI-Gas contended that the Mobil and CIPS exceptions were justified because these customers in no way contributed to the TOP liability. Staff agreed.

OPC and the Attorney General contended that TOP costs which the LDC does not charge to customers under a rate intended to prevent bypass should not be automatically recovered by allocating these costs to other customers. These unrecovered costs should either absorbed by the LDC or recovered when the LDC files to make-up the differential between contract discount revenues and full revenue requirements.

Staff witness Tripp made two other suggestions to LDCs in order to avoid bypass. First, she recommended that LDCs "unbundle" their rates which would make the rates more attractive to potential bypassers. An example of unbundling rates might be the providing of back-up service to transportation customers when they pay a specified charge. Second, she recommended that LDCs, in the face of competition, might want to voluntarily absorb a portion of the TOP costs. LDCs particularly disliked the latter recommendation. They considered such a recommendation contrary to the Interim Order entered in this docket.

Some LDCs, such as CILCO and Interstate, recommended that the Commission take into account not only potential bypass, but also switching to an alternate fuel such as oil by certain customers with a dual-fuel capability. Interstate also suggested that the 45-day rule proposed by Staff would be inapplicable if an LDC proposes no modification to its UPGA, or for good cause shown. Interstate would prefer an interest rate based upon an LDC's actual cost of money, rather than the 10% interest rate proposed by Staff.

Interim Order

In their Initial Briefs OPC and IIEC have requested that the Commission reconsider the Interim Order entered July 20, 1988. Prior to the entry of the Interim Order, initial briefs and reply briefs were filed by all parties, including OPC and IIEC. After the Hearing Examiner's Proposed Interim Order was distributed to all parties, exceptions and replies to exceptions were filed by the parties. OPC and IIEC were given ample opportunity to convince the Commission that the Hearing Examiner's Proposed Interim Order should not be entered by the Commission. The Hearing Examiner's Proposed Interim Order was adopted by the Commission on July 20, 1988. OPC and IIEC have failed to provide any new arguments which might cause the Commission to reconsider and amend the Interim Order. Their requests for reconsideration should be denied.

In its Initial Brief, Staff proposed that the Interim Order be clarified to indicate that Staff was opposed to IIEC's recommendation that the Commission should review potential offsetting factors to a full pass-through of TOP costs. This clarification is recommended by Staff for the prefactory portion of the Interim Order and so no amendment needs to be made to the Interim Order. The Commission recognizes Staff's position as stated in its Initial Brief.

Commission Conclusions

The evidence presented in this docket overwhelmingly favors the position of Staff on various issues. The Commission agrees that to the greatest extent possible a generic mechanism should be provided to recover TOP costs. The preferred recovery mechanism is the UPGA. A uniform volumetric methodology should be used as the appropriate TOP cost allocation recovery approach. Historically, this Commission has permitted demand charges and minimum commodity bills to be recovered through the UPGA. There is no practical difference between these charges and TOP costs. They may all be considered "gas costs" within the meaning of 83 Ill. Adm. Code 525.10. Because of the relatively short-lived nature of TOP costs recovery, the

UPGA is best-suited to recovery these costs. The UPGA is familiar to LDC customers and is a proven mechanism to track TOP costs which may, or may not, be volatile. The UPGA also has the advantages of timely recovery and an annual reconciliation for the protection of LDCs and customers alike.

The references by OPC and IIEC to FERC decisions, particularly FERC Order No. 500, has not swayed the Commission from its determination that the UPGA is the most appropriate TOP costs recovery mechanism. A review of FERC Order No. 500 shows that the proper mechanism for recovery of TOP costs is left to the states. The Pennsylvania Public Utility Commission's proposed Policy Statement on Recovery of Take-or-Pay Expenses issued October 22, 1988, is contrary to the Interim Order issued herein and would not permit timely recovery of TOP costs. The Diamond Shamrock case, supra, cited by IIEC is also not persuasive. That case merely recites the historical FERC policy of treating TOP payments as prepaid assets and ratebased in pipeline cases before FERC. The Commission's decision to use the UPGA as the primary TOP cost recovery mechanism reaffirms this Commission's policy with respect to the treatment of similar costs.

By this Order, the Commission does not rule out the possibility of approving a separate rider for an individual LDC. However, neither the OPC and IIEC proposals are acceptable to the Commission. As it now stands, a purchase deficiency approach is, at best, unworkable. OPC's allocation formula cannot be used without changes. The parties agree that TOP costs cannot be allocated on a cost causation basis. The Indiana Utility Regulatory Commission recently stated in the Northern Indiana Public Service Company, September 28, 1988 Order on Take-Or-Pay Liability, Cause No. 38380, page 13, that "it is a futile effort to engage in an inquiry as to the assessment of "blame" for NIPSCO's take-or-pay costs and it is equally futile if not totally impossible to assign cost responsibility on the same basis."

Both the OPC allocation method and the IIEC proposals either to excuse transportation customers, or impose a 1% revenue surcharge, suffer from being inequitable. OPC and IIEC would unfairly shift costs. The evidence shows that both sales and transportation customers have benefitted from spot gas purchases and open access transportation. Transportation customers, for the most part, are former sales customers. Transportation customers have helped in the creation of TOP liability by shifting from LDC system gas supply and have benefitted from open access transportation. On the foregoing bases, the OPC and IIEC proposal are rejected.

IP's proposed alternative, Rider H, cannot be accepted at this time. While the Commission does not share the Staff and IIEC's concern about setting a bad precedent, the Commission is not convinced from the state of this record that customers would bypass the IP system for an additional estimated lump-sum payment of .8 per therm when these customers marginal cost is currently 4 per therm (TR. 1130). Bypass could occur with or without the imposition of TOP charges. The Commission also needs more evidence presented on the impact of the exceptions to the lump sum payment, dual-fuel customers and those leaving IP's service territory. The Commission shares the Staff's concern about customers shifting production facilities outside IP's service territory to avoid the payment. Further evidence is also required on whether the lump sum payment is collectible both practically and legally. Given the foregoing considerations and concerns, despite IP's protest to the contrary, more evidence is required by the Commission prior to approval of Rider H. IP's current Rider H cannot be approved.

The Commission considers bypass to be a potential problem. CILCO, in particular, is faced with substantial loss of through-put. The anti-bypass tariffs of CILCO and NI-Gas appear to provide appropriate negotiated rates with potential bypassers and those customers should be exempt from TOP costs. All other customers benefit from the prevention of the loss of load. Riders similar to CILCO's Rate 10 and NI-Gas 17 would be looked on favorably by the Commission. NI-Gas has also shown that Mobil and CIPS have not contributed to the TOP liability due to their respective exchange agreement and transportation contract and so they should be exempt from any TOP liability.

Some LDCs, such as Interstate, propose Staff's exception for potential bypass be broadened to include dual-fuel users. No specific evidence has been presented in this docket regarding dual-fuel customers. While an exception should be made for potential bypass customers, no exception can be made for duel-fuel customers at this time.

The Commission is further of the opinion that transportation customers should share TOP costs on an equal, uniform volumetric basis with sales customers. This is most appropriate because transportation and sales customers helped cause the TOP costs liability and there appears no practical way to assign or allocate cost causation between these customer classes. Moreover, by assessing TOP costs on a uniform volumetric basis, it can be expected that transportation customers will continue to benefit from rates lower than sales customers. In the past, savings have accrued to transportation and sales customers on a volumetric basis. A uniform volumetric charge does not penalize transportation customers. Transportation and sales customers would pay their comparable share of an LDC's total cost of service, which is the proper reference point for determining any bias in the charges. The Commission cannot ignore the fact that transportation customers helped cause the TOP liability, benefitted from open access and so should also share in the recovery of TOP costs.

The Commission agrees with Staff on the following matters:

1) TOP charges not direct-billed should be paid by end-users using the services;

2) Only customers that use pipeline gas having TOP in commodity rates or customers that use gas transported over a pipeline with a volumetric surcharge would be assessed TOP charges that are not direct-billed by a pipeline;

3) A 10% interest rate should be used in the computation of interest charges which corresponds to the recovery period;

4) If an LDC uses a TOP rider, the LDC should: 1) Address the treatment of the ending TOP balance; and b) report the details of its direct-billed TOP costs in a similar manner to the monthly UPGA filings;

5) The reconciliation of TOP costs incurred and associated revenues recovered should be subject to audits with LDCs having the burden of proof regarding TOP costs and their recovery;

6) Each LDC should file its recovery mechanism proposal, UPGA or separate rider, within forty-five days from the date of this Order;

7) If a UPGA alternative rider is proposed, an LDC should conform to Staff's suggestions contained on page 7 of this Order.

Finally, Interstate's suggestion that an LDC which proposes no change in its UPGA could file a petition for a change in rates on less than forty-five days notice, which would be effective for service rendered on, and after January 1, 1989, has merit and should be adopted by the Commission.

The Commission, having given due consideration to the entire record herein and being fully advise in the premises, is of the opinion and finds that:

(1) by Order entered on April 17, 1988, this Commission initiated an investigation to determine the appropriate recovery of costs - incurred by Illinois gas utilities pursuant to FERC Order No. 500;

(2) all gas utilities subject to the jurisdiction of the Commission were made parties to the investigation;

(3) the Commission has jurisdiction over the parties and of the subject matter hereof;

(4) the recitals of fact and law and the conclusions reached thereon in the

prefatory portion of this Order are supported by the record and are hereby adopted as findings of fact and law;

(5) direct-billed pipeline TOP charges should preferably be recovered through an LDC's UPGA;

(6) direct-billed pipeline TOP charges may be allocated on a uniform volumetric basis to both sales and transportation classes, except that an LDC may make special contract provisions for potential bypassers by demonstrating that such anti-bypass contract would provide a net benefit to remaining customers;

(7) CILCO's Rate 10 and NI-Gas' Rate 17 are appropriate provisions to prevent uneconomic bypass and customers served under those rates should be excluded from assessment of TOP costs;

(8) NI-Gas' customers, Mobil and CIPS, should be specifically excluded from assessment of TOP costs;

(9) the specific alternative proposals of IP, OPC and IIEC should be rejected;

(10) each LDC which has not already done so should, within forty-five days after the service of this Order, file proposed changes in rates to implement a TOP recovery mechanism consistent with the findings and requirements set forth herein; the recovery mechanism must provide for recovery of TOP costs through a mechanism allocating the costs to sales and transportation customers

on a uniform volumetric basis; each utility should develop its own methodology to properly assess and recover its TOP costs with interest at an annual rate of 10% from the appropriate classes;

(11) an LDC whose methodology utilities and UGAC without modification should be allowed to file a petition for a change in rates on less than forty-five days' notice to be effective with service rendered on and after January 1, 1989;

(12) LDCs that deem it necessary to use a recovery vehicle other than the UGAC should file for a change in rates subject to forty-five days' notice and shall include the following items in its filing; (a) an explanation as to why the LDC's UGAC is not the appropriate mechanism for recovering the LDC's TOP charges and (b) an explanation as to why the LDC's proposed alternative is preferable; in explaining why its proposed alternative is preferable, a LDC should discuss at a minimum: (i) the low cost of implementation versus utilizing the LDC's UGAC, (ii) the timely recovery of TOP charges via the proposed alternative, (iii) how the proposed alternative fits the recovery cycle of TOP charges, (iv) how numerous additional filings are avoided, (v) the provision of an annual reconciliation methodology, and (vi) how the proposed alternative recovers TOP charges from the appropriate rate classes;

(13) the requests for oral argument filed by OPC, IIEC and IP should be denied;

(14) the findings and ultimate conclusions set forth in the Interim Order dated July 20, 1988 should be affirmed;

(15) any objections, petitions or motions made in this proceeding which remain undisposed of should be considered disposed of in a manner consistent with the ultimate conclusions contained herein

IT IS THEREFORE ORDERED that each gas utility file proposed changes in rates to implement its TOP recovery mechanism consistent with Findings (6), (10), (11) and (12) hereof.

IT IS FURTHER ORDERED that any objections, petitions or motions made in this proceeding which remain undisposed of be considered disposed of in a manner consistent with the ultimate conclusions contained herein.

By Order of the Commission this 22nd day of November, 1988.

(SIGNED) MARY B. BUSHNELL

Chairman

(SEAL)

U.S. CONSTITUTION & STATUTES

PUBLISHER'S NOTE:

The following pages are unavailable for filming:

A136 and A138

(c) The provisions of this chapter shall not apply to any person engaged in or legally authroized to engage in the transportation in interstate commerce or the sale in interstate commerce for resale, of natural gas received by such person from another person within or at the boudary of a State if all the natural gas so received is ultimately consumed within such State, or to any facilities used by such person for such transportation or sale, provided that the rates and service of such person and facilities be subjet to regulation by a State commission. The matters exempted from the provision of this chapter by this subsection are declared to be matters primarily of local concern and subject to regulation by the several States. A certification from such State commission to the Federal Power Commission that such State commission has regulatory authority over rates and service of such person and faciliites and is exercising such jurisdiction shall constitute conclusive evidence of such regulatory power or jurisdiction.

15 U.S.C. sect. 717(1)

Illinois Public Utilities Act, Ill. Rev. Stat., ch. 111 2/3, sect. 10-201 states:

Section 10-201. (a) Jurisdiction. Within 30 days after the service of any order or decision of the Commission refusing an application for a rehearing of any rule, regulation, order or decision of the Comission, including any order granting or denying interim rate relief, or within 30 days after the sercvice of any final order or decision of the Commission upon and after a rehearing of any rule, regulation, order or decision of the Commission, including any

Supreme Court, U.S.
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(2)

No. 91-381

In The
Supreme Court of the United States
October Term, 1991

The People of the State of Illinois
ex rel. The Office of Public Counsel,

Petitioner,

v.

The Illinois Commerce Commission, *et al.*,

Respondents.

**On Petition for Writ of Certiorari
to the Illinois Supreme Court**

BRIEF OF RESPONDENTS INTERSTATE POWER COMPANY AND CENTRAL ILLINOIS LIGHT COMPANY IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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October 3, 1991

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QUESTION PRESENTED FOR REVIEW

Petitioner misstates the holding which the Illinois Supreme Court did make: "that fundamental principles of Federal preemption, as reflected in the longstanding and consistent application of the filed rate doctrine, prohibit the ICC from conducting prudence reviews of FERC-mandated take-or-pay costs" and that "Illinois distributors must be allowed to pass through to their customers the full amount of these charges."[1] The Illinois Supreme Court thus held the Illinois Commerce Commission to be preempted from disallowing local distribution companies ("distributors") recovery of those costs. Furthermore, the Federal Energy Regulatory Commission ("FERC") was determined not to be empowered by the Natural Gas Act to implement FERC's intent to permit states to disallow portions of such costs.

Accordingly, the issue is whether the Supremacy Clause of the U.S. Constitution precludes the States from disallowing recovery in retail rates of local distribution companies of direct-billed take-or-pay costs included in FERC-approved wholesale rates.

---

[1] *General Motors Corp. v. Illinois Commerce Comm'n.,* 143 Ill.2d 407, 424, 574 N.E.2d 650, 659 (1991) (Pet. p. A32).

LIST OF ALL PARTIES TO THE PROCEEDING

The People of the State of Illinois *ex rel.*
  The Office of Public Counsel
General Motors Corporation
Quantum Chemicals Company, USI Division
USX Corporation
Modern Drop Forge Company
Acme Steel Company
Viskase Corporation
Thomas Steel Company
LTV Steel Company
Alumax Mill Products, Inc.
Wagner Castings Company
Archer Daniels Midland Company
PPG Industries, Inc.
Owens-Illinois, Inc.
A. O. Smith Corporation
General Tire Company
Illinois Commerce Commission
Peoples Gas, Light & Coke Company
North Shore Gas Company
Illinois Power Company
Central Illinois Light Company
Union Electric Company
Interstate Power Company
Northern Illinois Gas Company
Iowa-Illinois Gas & Electric Company
Central Illinois Public Service Company
United Cities Gas Company
Mt. Carmel Public Utility Company
Monarch Gas Company
Tennessee Gas Pipeline Company
Midwestern Gas Transmission Company

Phoenix Chemical Company
Neil F. Hartigan, Attorney General of the
State of Illinois on behalf of The
People of the State of Illinois
Richard Daley, Cook County State's Attorney
Wisconsin Power & Light Company
Citizens Utility Board

Interstate Power Company has no parent or subsidiary company to be listed.

Central Illinois Light Company is a subsidiary of its parent, CILCORP Inc.; Central Illinois Light Company has no subsidiary company to be listed.

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No. 91-381

IN THE
Supreme Court of the United States
OCTOBER TERM, 1991

THE PEOPLE OF THE STATE OF ILLINOIS
ex rel. THE OFFICE OF PUBLIC COUNSEL,

Petitioner,

v.

THE ILLINOIS COMMERCE COMMISSION, *et al.*,

Respondents.

**On Petition for Writ of Certiorari
to the Illinois Supreme Court**

BRIEF OF RESPONDENTS INTERSTATE POWER COMPANY AND CENTRAL ILLINOIS LIGHT COMPANY IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

STATEMENT OF JURISDICTION

Contrary to the misstatement of petitioner that "[t]he decision of the Illinois Supreme Court creates serious conflicts with United States Supreme Court case law and the Natural Gas Act" (Pet. p. 2), the decision of the Illinois Supreme Court is wholly consistent with, and predicated upon, the Natural Gas Act and the decisions of this Court confirming Congress' intent as expressed in the Natural Gas Act to "occupy the field" in regulating interstate gas service and rates, and the decisions of this Court pronouncing the rule of federal preemption, mandated by the Supremacy Clause of the United States Constitution (U.S. Const., art. VI, cl. 2), known as the filed rate doctrine. Moreover, the decision of the Illinois Supreme Court leads to the conclusion that, even if the filed rate doctrine permitted State disallowance of interstate gas rates, "unless clairvoyance has become an element of prudence, there simply is no basis on which the ICC could conduct a meaningful prudence review,"[2] thus evidencing an independent state law basis for the Illinois Supreme Court's decision.

CONSTITUTIONAL PROVISION AND STATUTE INVOLVED

The Supremacy Clause of the United States Constitution:

> This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

U.S. Const., art. VI, cl. 2.

The Natural Gas Act, section 1(b):

> (b) The provisions of this chapter shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural gas companies engaged in such transportation or sale, but shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas.

15 U.S.C., Sec. 717(b).

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[2] *General Motors Corp. v. Illinois Commerce Comm'n.,* 143 Ill.2d 407, 424, 574 N.E.2d 650, 659 (1991) (Pet. p. A32).

STATEMENT OF THE CASE

Respondents Interstate Power Company and Central Illinois Light Company submit the following comments deemed most necessary to correct inaccuracies and omissions in petitioner's Statement Of The Case:

Petitioner's reference to "the Sixth Amendment" (Pet. pp. 2-3) presumably should be to the Supremacy Clause of the United States Constitution, U.S. Const., art. VI, cl. 2.

The Illinois Supreme Court held the Illinois Commerce Commission to be preempted from disallowing recovery by local distribution companies of FERC-mandated take-or-pay costs, but did not preclude the Illinois Commission from allocating recovery of such costs among distributors' state-jurisdictional customers.

The take-or-pay costs at issue are costs which interstate pipeline companies, each operating in more than a single state, paid pursuant to contracts between them and their suppliers, and which were imposed upon distributors by FERC as part of interstate natural gas pipeline rates.

The arguments set forth in petitioner's Statement Of The Case at pages 9-10 and 14-16 as to the Illinois Supreme Court's decision are responded to in the following Argument In Opposition.

SUMMARY OF ARGUMENT

Congress' intent to occupy the entire field of wholesale interstate sale of natural gas is clear. FERC's contrary intent is irrelevant in view of the clear intent of Congress. All costs at issue are subject to the exclusive federal jurisdiction of FERC over the interstate sale of wholesale gas, and the "Hinshaw pipeline" exception[3] is inapplicable to those costs. The filed rate doctrine, as applied by this Court in *Nantahala*[4] and *Mississippi Power,*[5] preempts Illinois from "trapping", or disallowing recovery of costs which local distribution companies are mandated to pay under FERC orders allocating take-or-pay costs. Accordingly, the decision of the Illinois Supreme Court is wholly consistent with decisions of this Court, and no reason exists to grant review.

---

[3] Natural Gas Act section 1(c) (15 U.S.C.; Sec. 717[c]).

ARGUMENT

Interstate Power Company and Central Illinois Light Company, respondents, submit the following arguments in opposition to the petition for writ of certiorari submitted on behalf of petitioner, The People of the State of Illinois *ex rel.* The Office of Public Counsel. These respondents will demonstrate that misstatements of law and fact as to the jurisdiction of the Federal Energy Regulatory Commission ("FERC") over take-or-pay costs incurred by interstate pipeline companies, upon which petitioner bases its further arguments, have resulted in petitioner's misstatement of the issue determined by the Illinois Supreme Court, and consequently of the questions presented for review before this Court.

Petitioner concedes the "three circumstances" under which federal law preempts state law (Pet. p. 19). In doing so, petitioner specifically concedes that preemption occurs when *Congress* indicates an intention to occupy the entire field of regulation of a particular subject matter (Pet. p. 19), and acknowledges that "the first step in any preemption analysis is whether or not *Congress* expresses an intent to fully occupy a particular area of regulation" (Pet. p. 29). That first step may also be the last step, because "[i]f the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress." *Chevron U.S.A. v. Natural*

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[4] *Nantahala Power & Light Co. v. Thornburg,* 476 U.S. 953, 90 L.Ed.2d 943, 106 S.Ct. 2349 (1986).

[5] *Mississippi Power & Light Co. v. Mississippi ex rel. Moore,* 487 U.S. 354, 101 L.Ed.2d 322, 108 S.Ct. 2428 (1988).

Resources Defense Counsel, 467 U.S. 837, 842-43, 81 L.Ed.2d 694, 104 S.Ct. 2778 (1984).

Petitioner mistakenly argues that because Congress intended that states continue to regulate *intrastate* gas service (Pet. pp. 20-21), the Illinois Supreme Court's conclusion that "Congress intended Federal law to occupy the field of regulating *interstate* sale of wholesale gas . . ." conflicts with the Natural Gas Act and this Court's decisions in *Nantahala Power & Light Co. v. Thornburg,* 476 U.S. 953, 90 L.Ed.2d 943, 106 S.Ct. 2349 (1986) ("*Nantahala*"), and *Mississippi Power & Light Co. v. Mississippi ex rel. Moore,* 487 U.S. 354, 101 L.Ed.2d 322, 108 S.Ct. 2428 (1988) ("*Mississippi Power*") (Pet. pp. 17-18) (emphasis supplied).

In so arguing, petitioner asserts that, in enacting the Natural Gas Act, Congress had no purpose or effect to cut down state power, citing as authority *Panhandle Eastern Pipe Line Co. v. Public Service Commission of Indiana,* 332 U.S. 507, 92 L.Ed. 128, 68 S.Ct. 190 (1947) ("*Panhandle-Indiana*"), and invoking *California Coastal Comm'n. v. Granite Rock Co.,* 480 U.S. 572, 94 L.Ed.2d 577, 107 S.Ct. 1419 (1987). Petitioner contends that states therefore have some reserved authority to "review" FERC's allocation of take-or-pay charges included in interstate wholesale rates. Petitioner's contention has been addressed recently in *Public Utilities Comm'n. of the State of Cal. v. FERC,* 900 F.2d 269 (D.C. Cir. 1990), where the non-FERC jurisdictional "pre-existing state power" addressed in *Panhandle-Indiana* was distinguished from the lack of state power over the regulation of the interstate transportation of gas and wholesale interstate sales:

> First we must correct California's assumption that FERC's and its jurisdiction are concurrent, an assumption that leads it to invoke *California Coastal Comm'n. v. Granite Rock Co.,* 480 U.S. 572, 107 S.Ct. 1419, 94 L.Ed.2d 577 (1987), for the idea that it may control the transportation so long as its regulations reasonably accommodate federal con-

> cerns. But in *Granite Rock* the Court had found that no federal statute was intended to preempt all state environmental regulation. *Id.* at 588, 107 S.Ct. at 1429. Here, if there be Commission jurisdiction over some component of the transaction, it is exclusive over that component.

900 F.2d at 274.

This Court has held in numerous cases that, in adopting the Natural Gas Act, Congress clearly expressed its intent to totally preempt the regulation of wholesale gas rates in interstate commerce. In *Illinois Natural Gas Co. v. Central Illinois Public Service Co.,* 314 U.S. 498, 506, 86 L.Ed. 371, 62 S.Ct. 384, 387 (1942), this Court in a footnote quoted from H.R. No. 709, *Committee on Interstate and Foreign Commerce,* 75th Cong., 1st Sess., April 28, 1937, with respect to the bill which became the Natural Gas Act:

> It confers jurisdiction upon the Federal Power Commission over the transportation of natural gas in interstate commerce, and the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial or any other use. The States have, of course, for many years regulated sales of natural gas to consumers in intrastate transactions. The States have also been able to regulate sales to consumers even though such sales are in interstate commerce, such sales being considered local in character and in the absence of congressional prohibition subject to State regulation. (Citation omitted.) There is no intention in enacting the present legislation to disturb the States in their exercise of such jurisdiction. However, in the case of sales for resale, or so-called wholesale sales, in interstate commerce (for example, sales by producing companies to distributing companies) the legal situation is different. Such transactions have been considered to be not local in character and, even in the absence of Congressional acts, not subject to State regulation. (Citation omitted.) *The basic purpose of the present legislation is to occupy this field in which the Supreme Court has held that the States may not act.*

(Emphasis added).

In *Federal Power Commission v. Hope Natural Gas Co.,* 320 U.S. 591, 649, 88 L.Ed. 333, 64 S.Ct. 281, 291 (1944), this Court pointed out that "the purpose of the Natural Gas Act was to provide 'through the exercise of the national power over interstate commerce, an agency for regulating the wholesale distribution to public service companies of natural gas moving interstate, which the Court had declared to be interstate commerce not subject to certain types of state regulation.' As stated in the House Report, the 'basic purpose' of the legislation was 'to occupy' the field. . . . " See also *Schneidewind v. ANR Pipe Line Co.,* 485 U.S. 293, 99 L.Ed.2d 316, 108 S.Ct. 1145 (1988), and *Michigan Consolidated Gas v. Panhandle Eastern Pipeline,* 887 F.2d 1295 (6th Cir. 1989).

Accordingly, the dual federal-state system of regulation referred to by petitioner is *not* a system which permits co-extensive regulation over single components of a transaction. FERC's jurisdiction over wholesale interstate sale of natural gas is exclusive. States, in the exercise of their jurisdiction over the local distribution of natural gas, have no power over FERC-determined rates for the interstate wholesale of natural gas. Thus, as the Illinois Supreme Court has determined, it is impermissible for states to trap FERC-mandated charges by disallowing recovery of those charges in distributors' retail rates.

Far from conflicting with this Court's decisions in *Nantahala* and *Mississippi Power*, the decision of the Illinois Supreme Court is consistent with and compelled by this Court's holdings in *Nantahala* ("[F]or a state ratemaking agency to disregard a FERC-filed rate would be clearly inconsistent with the federal regulatory scheme over interstate wholesale power prices"[6]) and as quoted with approval in *Mississippi Power* ("[W]hen FERC sets a rate between a seller of power and a wholesaler-as-buyer, a State may not exercise its undoubted jurisdiction over retail sales to prevent the wholesaler-as-seller from recovering the costs of paying the FERC-approved rate. . . . such a 'trapping' of costs is prohibited."[7])

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[6] 476 U.S. at 969, 90 L.Ed.2d at 956, 106 S.Ct. at 2358.

Petitioner refers to and quotes extensively from Natural Gas Act section 1(c) (15 U.S.C., Sec. 717[c]), which created the "Hinshaw pipeline" exception for a company transporting gas in interstate commerce but operating exclusively in one state ("The provisions of this chapter shall not apply to any person engaged in . . . the transportation in interstate commerce or the sale in interstate commerce for resale, of natural gas received . . . within or at the boundary of a State if all the natural gas so received is ultimately consumed within such State"). That exception is not applicable here, for all take-or-pay costs at issue are included in wholesale rates of companies operating in and transporting gas in interstate commerce between more than one state. Any implication that any of the take-or-pay costs at issue here arose from transportation or sale other than in more than one state, by petitioner's reference to Natural Gas Act section 1(c), is mistaken.

Petitioner mistakenly asserts that distributors had argued that FERC's desire and intent that state commissions have the ability to compel prudence reviews and "equitable sharing" of FERC-approved take-or-pay costs was unclear, and that the Illinois Supreme Court "inappropriately accepted those arguments" (Pet. pp. 34-35). In fact, FERC's intent that states could disallow recovery by local distributors of a portion of the take-or-pay costs direct-billed to them by their pipeline suppliers was expressly acknowledged by distributors with reference to Order 500-H, and recognized by the Illinois Supreme Court.[8] Distributors and the Illinois Supreme Court did not dispute FERC's intent, they properly concluded "that FERC's intent is irrelevant to the application of the filed rate doctrine in the context of retail ratemaking"[9] in view of the "clear and controlling" intent of Congress:

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[7] 487 U.S. at 372, 101 L.Ed.2d at 338-39, 108 S.Ct. at 2438.

[8] *General Motors Corp. v. Illinois Commerce Comm'n.*, 143 Ill.2d 407, 418-19, 574 N.E.2d 650, 656-57 (1991) (Pet. p. A19-20).

> States may not bar regulated utilities from passing through to retail consumers FERC-mandated wholesale rates. *Mississippi Power,* 887 U.S. at 372, 101 L.Ed.2d at 338, 108 S.Ct. at 2439. *See also Nantahala,* 476 U.S. at 970, 90 L.Ed.2d at 956, 106 S.Ct. at 2358-59; *City of Chicago,* 113 Ill.2d at 616.[10]

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[9] *General Motors Corp. v. Illinois Commerce Comm'n.,* 143 Ill.2d 407, 419, 574 N.E.2d 650, 656 (1991) (Pet. p. A21).

[10] *General Motors Corp. v. Illinois Commerce Comm'n.,* 143 Ill.2d 407, 421, 574 N.E.2d 650, 657-58 (1991) (Pet. p. A26).

CONCLUSION

Because the intent of Congress to occupy the field of regulating the interstate sale of natural gas at wholesale is clear, because the intent of FERC is irrelevant in the face of that clear intent of Congress, because the "Hinshaw pipeline" exception to the Natural Gas Act is inapplicable, and because the decision of the Illinois Supreme Court is accordingly consistent with and compelled by the Natural Gas Act and the decisions of this Court in *Nantahala* and *Mississippi Power* in holding the filed rate doctrine to preclude the disallowance of FERC-approved take-or-pay costs, the petition for writ of certiorari should be denied.

Respectfully submitted,

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No. 91-381

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IN THE
Supreme Court of the United States
OCTOBER TERM, 1991

THE PEOPLE OF THE STATE OF ILLINOIS,
***ex rel.*, THE OFFICE OF PUBLIC COUNSEL,**
Petitioner,
v.
THE ILLINOIS COMMERCE COMMISSION, *et al.*,
Respondents.

Petition for Writ of Certiorari
to the Illinois Supreme Court

BRIEF OF RESPONDENTS NORTHERN ILLINOIS GAS COMPANY, ILLINOIS POWER COMPANY, IOWA-ILLINOIS GAS AND ELECTRIC COMPANY, UNITED CITIES GAS COMPANY, MT. CARMEL PUBLIC UTILITY CO., CENTRAL ILLINOIS PUBLIC SERVICE COMPANY, THE PEOPLES GAS LIGHT AND COKE COMPANY, NORTH SHORE GAS COMPANY, AND UNION ELECTRIC COMPANY IN OPPOSITION TO THE PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

In 1988, the Illinois Commerce Commission authorized Illinois utilities to recover from their retail customers 100 percent of certain pipeline charges that the utilities had been required to pay as a result of orders issued by the Federal Energy Regulatory Commission ("FERC"). The Commerce Commission declined to conduct a prudence review of these charges on the ground that it was preempted from doing so by the filed rate doctrine as applied in *Nantahala Power & Light Co.* v. *Thornburg*, 476 U.S. 953 (1986), and *Mississippi Power & Light Co.* v. *Moore*, 487 U.S. 354 (1988). On appeal, the Illinois Supreme Court affirmed.

The only issue properly presented in this Court is whether the Illinois Supreme Court erred in holding that the Supremacy Clause of the United States Constitution precludes a state commission from conducting a "prudence review" to determine the extent to which interstate pipeline charges that utilities unavoidably incurred as a result of orders issued by the FERC should be allowed in setting retail rates.

STATEMENT PURSUANT TO RULE 29.1

Respondent Northern Illinois Gas Company is a wholly-owned subsidiary of NICOR Inc. It has no subsidiaries other than wholly-owned subsidiaries.

Respondent Iowa-Illinois Gas and Electric Company has no parent company and no subsidiaries other than wholly-owned subsidiaries.

Respondent Illinois Power Company has no parent company. It has the following subsidiaries that are not wholly-owned: Illinois Power Fuel Company and Electric Energy, Inc.

Respondent Central Illinois Public Service Company is a wholly-owned subsidiary of CIPSCO, Inc. It has the following subsidiary that is not wholly-owned: Electric Energy, Inc.

Respondent United Cities Gas Company has no parent company or subsidiaries other than wholly-owned subsidiaries.

Respondent Mt. Carmel Public Utility Company has no parent company and no subsidiaries.

Respondents The Peoples Gas Light and Coke Company and North Shore Gas Company are wholly-owned subsidiaries of Peoples Energy Corporation. Neither respondent has any subsidiaries other than wholly-owned subsidiaries.

Respondent Union Electric Company has no parent company. It has the following subsidiary that is not wholly-owned: Electric Energy, Inc.

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No. 91-381

IN THE
Supreme Court of the United States
OCTOBER TERM, 1991

THE PEOPLE OF THE STATE OF ILLINOIS, *ex rel.*, THE OFFICE OF PUBLIC COUNSEL,
Petitioner,
v.
THE ILLINOIS COMMERCE COMMISSION, *et al.*,
Respondents.

Petition for Writ of Certiorari to the Illinois Supreme Court

BRIEF OF RESPONDENTS NORTHERN ILLINOIS GAS COMPANY, ILLINOIS POWER COMPANY, IOWA-ILLINOIS GAS AND ELECTRIC COMPANY, UNITED CITIES GAS COMPANY, MT. CARMEL PUBLIC UTILITY CO., CENTRAL ILLINOIS PUBLIC SERVICE COMPANY, THE PEOPLES GAS LIGHT AND COKE COMPANY, NORTH SHORE GAS COMPANY, AND UNION ELECTRIC COMPANY IN OPPOSITION TO THE PETITION FOR WRIT OF CERTIORARI

STATEMENT OF THE CASE

In its opinion, the Illinois Supreme Court described this case as a "classic situation for application of the [filed rate] doctrine, for it involves an intermediary faced with a FERC-set wholesale rate, who would, if the doctrine were not applied, be forced to sell power at less than its reasonable cost as determined by FERC." Petn. at A30. The factual background supporting that conclusion is as follows.

Prior to 1985, the FERC tightly controlled the interstate market for natural gas. Only pipelines sold natural gas on an interstate basis, with the FERC setting both the well-head price paid to gas producers by the pipelines and the wholesale rates pipelines were allowed to charge to "local distribution companies" ("LDCs") like respondents. In the 1970s, FERC-approved well-head prices were often maintained at artificially low levels, making it difficult for pipelines to secure adequate sources of supply. Those difficulties increased during the natural gas shortage of the 1970's. In order to guarantee their sources of supply in this market, virtually all of the interstate pipelines entered into long-term "take-or-pay" contracts with producers. Under those contracts, the pipelines agreed to take a certain amount of gas each year or pay for any gas not taken. *See* R. Vol. IX, Tab 28 at 5-6.

In the late 1970's deregulation began. Under the Natural Gas Policy Act of 1978, well-head prices were gradually deregulated. That deregulation had the effect of encouraging production to the point where a gas surplus developed. Although well-head prices fell as a result of this so-called gas "bubble," LDCs were unable to take advantage of the lower prices because the pipelines that controlled the transportation of gas typically refused to transport gas they themselves did not sell.

In 1985, the FERC responded to this situation by adopting an "open access" transportation policy. Under the open access policy, interstate pipelines were no longer permitted to monopolize natural gas sales. Instead, they were required to offer non-discriminatory access to their pipelines to all entities if they allowed any third party to transport over their systems. *See* FERC Order No. 436, 50 Fed. Reg. 42408, 33 FERC Statutes and Regulations ¶ 61,007 (Oct. 18, 1985). As a result of this new policy, an LDC could, for the first time, purchase substantial volumes of gas directly from a producer and transport it over an interstate pipeline system, without using the pipeline as a middleman in the sale. Because the open access policy was introduced at a time when there was a natural gas surplus, a strong "spot" market developed in which gas could be purchased directly from producers at unregulated prices that were often far lower than those charged by the pipelines under FERC-approved rates. *See* R. Vol. V at C-01501; Commission Order of November 22, 1988 at 4; R. Vol. IX, Tab 28 at 5-16.

The FERC's open access policy proved to be a boon to consumers. With the strong encouragement of the Illinois Commerce Commission, many Illinois LDCs reduced their gas costs significantly by buying on the spot market. These cost savings were passed on immediately, in their entirety, to the LDCs' customers through the purchased gas adjustment clauses in the LDCs' tariffs.[1]

For the pipelines, however, the FERC's open access policy represented a potential financial disaster. Because their cost of purchasing gas was often locked in at what were now above-market prices by long-term take-or-pay contracts, the pipelines were unable to reduce their prices to meet competition from the spot market. As a result, the pipelines could not sell all of the gas they were required to take or pay for under their contracts with gas producers. If they had been held strictly to their contractual obligations to pay for all of the gas they could no longer sell, the pipelines would have owed literally billions of dollars to producers. *See* R. Vol. IX, Tab 28 at 3-16.

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[1] For example, during the period from January 1984 through April 1988, Northern Illinois Gas Company's customers alone saved at least $340 million as a result of spot market purchases. *See* R. Vol. IX, Tab 26 at 9-10; Tab 27 at 14-15; Tab 36; Tab 38.

For two years, the FERC was silent as to how the take-or-pay crisis would be resolved. Finally, in August 1987, the FERC issued Order No. 500, which established a framework for recovery of costs incurred by pipelines in settling or paying their take-or-pay liabilities. *See* 52 Fed. Reg. 30334 (August 14, 1987). Under Order No. 500, pipelines retained a right to seek full recovery of all of their take-or-pay liabilities in a traditional FERC ratemaking proceeding.[2] At the same time, however, the FERC offered a newly-crafted "voluntary" alternative, promising pipelines guaranteed recovery of up to one-half of their take-or-pay costs if they agreed to absorb an equal amount without seeking recovery from the LDCs.

In order to persuade the pipelines to accept the guaranteed recovery alternative, the FERC promised pipelines a new and different recovery mechanism. Instead of adding the take-or-pay costs into the pipelines' current wholesale gas rates, the FERC allowed pipelines that elected the alternative method to bill LDCs directly for their share of the charges in question. These direct-billed costs were allocated by FERC order to all LDCs that had purchased gas from the pipeline during a particular period of time, regardless of whether they continued to do business with the pipeline. The allocation was based on each customer's contribution to the pipeline's decline in sales between an historical "base period" (generally before the open access policy went into effect) and an historical "comparison period" (generally a specific period after the open access policy went into effect). Under this "purchase deficiency" method of allocation, LDCs that had taken advantage of the spot market to lower their gas costs were required to bear the brunt of the take-or-pay costs.[3]

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[2] Under Section 4 of the Natural Gas Act, 15 U.S.C. § 717c, interstate pipelines have a right to recover in their wholesale rates any and all "just and reasonable" costs they "prudently" incurred to purchase gas.

By divorcing the take-or-pay recovery mechanism from the pipelines' current wholesale gas prices, the FERC made its guaranteed recovery alternative the only viable economic choice for most pipelines. Pipelines that insisted on claiming full recovery of their take-or-pay costs in a traditional rate-making proceeding faced not only uncertainty as to the amount the FERC would allow them to recover, but also the possibility of large increases in their wholesale rates that would make it difficult, if not impossible, for them to compete in the marketplace for gas sales.[4] On the other hand, pipelines that agreed to absorb up to one-half of their take-or-pay costs would be able to maintain their wholesale prices at competitive levels, while at the same time knowing that they would recover the other half of their take-or-pay costs from LDCs, who were compelled by the FERC to pay the costs directly billed to them.

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[3] For example, assume that a pipeline had three LDC customers. Customer A bought the same amount of gas (100 Mcf per year) from the pipeline in the comparison period as it had in the base period. Customer B reduced its pipeline purchases from 100 Mcf to 75 Mcf per year, and Customer C reduced its pipeline purchases from 100 Mcf to 50 Mcf per year. If the pipeline had $200 in take-or-pay liability and agreed to absorb $100, it would be able to direct bill $100 to its customers. That $100 would be allocated among the LDCs based on each LDC's contribution to the total shortfall of 75 Mcf between the two periods (300 Mcf per year in the base period vs. 225 Mcf per year in the comparison period). Customer A would pay nothing under Order No. 500 because it had not contributed to the shortfall. Customer B would pay ⅓ (25/75) of the $100 and Customer C would pay ⅔ (50/75) of the $100.

[4] Of course, if they were unable to sell a sufficient quantity of gas, pipelines electing the traditional alternative would be unable to recover their take-or-pay costs in fact, even though they were authorized to do so in theory.

The vast majority of the pipelines serving Illinois LDCs elected the guaranteed recovery alternative. *See* R. Vol. V at C-01501. By Order dated April 27, 1988, the Illinois Commerce Commission initiated a generic proceeding to determine on what basis the LDCs would be permitted to recover direct-billed take-or-pay costs from their retail customers in Illinois. In November 1988, the Commission issued a final order concluding that it was precluded by the filed rate doctrine from disallowing any portion of the direct-billed costs imposed on the LDCs as a result of Order No. 500 and individual FERC ratemaking proceedings. The Commission therefore authorized Illinois LDCs to file tariffs to recover 100% of their FERC-allocated take-or-pay costs from their customers. *See* R. Vol. V at C-01498 to C-01514.

The Office of Public Counsel ("OPC"), an Illinois consumer advocacy group, appealed to the Illinois Appellate Court, which reversed the Commission's order. In its opinion, the Appellate Court relied heavily on suggestions by the FERC that all segments of the natural gas industry, including the LDCs, should "share" in the cost of discharging take-or-pay liabilities by agreeing to absorb some portion of those costs, rather than passing them along to the next link in the distribution chain. The Appellate Court held that this suggestion was enough to dispel the preemptive effect that the FERC allocation of direct-billed costs ordinarily would have. The Appellate Court then remanded to the Illinois Commerce Commission for an inquiry into (1) the "sharing" of take-or-pay costs between LDCs and their ratepayers and (2) the prudence of the past purchasing practices of the LDCs as they related to take-or-pay costs.

On appeal, the Illinois Supreme Court unanimously reversed the Appellate Court's decision, reinstating the Commerce Commission's order. The Supreme Court held that the FERC's suggestions with respect to industry sharing were completely irrelevant. It also held that the take-or-pay costs allocated by the FERC to the LDCs were unavoidable and unforeseeable. Under those circumstances, the Court found no room for an exception to the filed rate doctrine.

REASONS FOR DENYING THE WRIT

This is not a case in which a petition for certiorari should be granted. There is no conflict between the Illinois Supreme Court's decision and any ruling by this Court. On the contrary, as the Illinois Supreme Court stated, this case presents a "classic situation" for application of the filed rate doctrine, as that doctrine has been explained and applied by this Court in *Nantahala Power & Light Co.* v. *Thornburg*, 476 U.S. 953 (1986), and *Mississippi Power & Light Co.* v. *Moore*, 487 U.S. 354 (1988). OPC's contention that the Illinois Supreme Court improperly ignored the views of a federal agency with respect to preemption dissolves in the face of the clear *congressional* intent, which has repeatedly been recognized by this Court, to preempt precisely the kind of state interference with FERC-allocated costs that OPC would have the Illinois Commerce Commission engage in here.

Because the contours of the filed rate doctrine have been clearly defined by this Court in *Nantahala* and

Mississippi Power, this case involves only the application of a clear rule to a particular set of facts. There is no conflict among the state supreme courts or the lower federal courts about the proper application of the test; indeed, the Illinois Supreme Court is the *only* appellate court that has to date addressed the application of the filed rate doctrine to take-or-pay costs allocated to LDCs by the FERC. And, because the FERC's allocation method was struck down in 1989 by the District of Columbia Circuit in *Associated Gas Distributors* v. *FERC*, 893 F.2d 349 (D.C. Cir. 1989), *cert. denied*, 111 S.Ct. 277 (1990), it is unlikely that the same fact pattern will be repeated again in subsequent cases.

In addition to all of these factors, there is an independent state law ground to support the decision below. In the Illinois Supreme Court, respondents argued that the Illinois Commerce Commission had already found the purchasing decisions that later resulted in allocations of take-or-pay costs to be "prudent," in orders that had long since become final. Respondents argued that there was no basis under Illinois law to reopen those decisions in order to conduct a hindsight review of the "prudence" of the purchasing decisions that ultimately led to imposition of those costs. Although the Illinois Supreme Court did not rule on this specific issue, it did agree with respondents that the take-or-pay costs were unforeseeable and that consequently there was no logical basis for conducting any type of prudence review.

I. The Illinois Supreme Court's Decision Does Not Conflict With Any Decision By This Court.

A. *Nantahala* and *Mississippi Power* Are Squarely Applicable To The Case At Bar.

When Congress enacted the Federal Power Act and the Natural Gas Act, it set up a system for regulating energy prices that contained an inherent potential for conflict. With federal agencies regulating wholesale prices and individual state agencies regulating retail prices, there was always the possibility that LDCs might be whip-sawed by conflicts between state and federal regulators, being required to pay a particular price by FERC, but not being able to recover that cost in full from their customers because a state regulator considered the price unreasonable.

In *Nantahala Power & Light Co.* v. *Thornburg*, 476 U.S. 953 (1986), this Court held that Congress had intended to eliminate any possibility of such a conflict by giving the FERC exclusive and plenary jurisdiction over wholesale utility rates. That means that once the FERC decides that a wholesale price is a reasonable price for a pipeline to charge, a state regulatory commission must accept the fact that it is also a reasonable price for an LDC to pay. A state commission cannot "trap" costs at the state level that have been judged reasonable by the FERC by refusing to permit a utility to recover them in full in its retail rates:

> "The filed rate doctrine ensures that sellers of wholesale power governed by FERC can recover the costs incurred by their payment of just and reasonable FERC-set rates. When FERC sets a rate between a seller of power and a wholesaler-as-buyer, a State may not exercise its undoubted jurisdiction over retail rates to prevent the wholesaler-as-seller from recover-

> ing the costs of paying the FERC-approved rate. . . . Such a trapping of costs is prohibited." 476 U.S. at 970.

In *Mississippi Power & Light Co.* v. *Moore*, 487 U.S. 354 (1988), this Court extended the rationale of *Nantahala*, holding that the prohibition on reconsideration of FERC allocation decisions at the state level could not be evaded through use of a "prudence" review.[5] At issue in *Mississippi Power* was a FERC allocation of a nuclear power plant's capacity costs among several electric utilities that had joined together to construct the plant. The Mississippi Supreme Court held that one of the utilities, MP&L, could not recover all of the capacity costs allocated to it by the FERC on the ground that the Mississippi Public Service Commission was first required to examine the prudence of the management decisions that led to MP&L's participation in the construction of the plant. On appeal, this Court reversed, holding that a prudence review by state regulators was preempted under the Supremacy Clause. In reaching this result, the Supreme Court expressly reaffirmed its decision in *Nantahala*:

> "Our decision in *Nantahala* relied on fundamental principles concerning the pre-emptive impact of federal jurisdiction over wholesale rates on state regulation. First, FERC has exclusive authority to determine the reasonableness of wholesale rates. . . . Second, FERC's exclusive jurisdiction applies not only to rates, but also to power allocations that affect

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[5] Although *Nantahala* and *Mississippi Power* were decided under the Federal Power Act rather than the Natural Gas Act, the two statutes " 'are in all material respects substantially identical,' and decisions interpreting them may be cited interchangeably." *Kentucky West Virginia Gas Co.* v. *Pennsylvania Public Util. Comm'n*, 862 F.2d 69, 74 n. 8 (3d Cir. 1988), citing *Arkansas Louisiana Gas Co.* v. *Hall*, 453 U.S. 571, 577 n.7 (1981).

> wholesale rates. *Id.* at 966. Third, ***States may not bar regulated utilities from passing through to retail consumers FERC-mandated wholesale rates.*** . . . These principles led us to hold in *Nantahala* that the North Carolina Utilities Commission's order "trapping" federally mandated costs was pre-empted. Today they compel us to hold that the MPSC may not enter an order "trapping" the costs MP&L is mandated to pay under the FERC order allocating Grand Gulf power or undertake a "prudence" review for the purpose of deciding whether to enter such an order." 487 U.S. at 371-72 (emphasis added).

The Court observed that a state prudence review may be appropriate where the LDC had a choice as to whether or not to incur such costs. Thus, if the FERC had approved both high and low cost power rates by two different wholesale suppliers, a state commission could properly consider a utility's prudence if it decided to purchase the higher cost power. However, the Court held that a state prudence review is necessarily preempted where the utility has no legal right to avoid the costs in question:

> "As we assumed [in *Nantahala*], it might well be unreasonable for a utility to purchase unnecessary quantities of high cost power, even at FERC-approved rates, if it had the legal right to refuse to buy that power. But if the integrity of FERC regulation is to be preserved, it obviously cannot be unreasonable for MP&L to procure the particular quantity of high-priced Grand Gulf power that FERC has ordered it to pay for. Just as Nantahala had no legal right to obtain any more low cost TVA power than the amount allocated by FERC, it is equally clear that MP&L may not pay for less Grand Gulf power than the amount allocated by FERC." 487 U.S. at 373-74.

As the Illinois Supreme Court observed, this case presents a "classic situation" for application of the filed rate doctrine set forth in *Nantahala* and *Mississippi Power.*

The LDCs here are indistinguishable from the example cited in *Nantahala* of "a middleman [who] faces a FERC-fixed wholesale rate charged by a power supplier." In that situation, a state agency setting retail rates simply cannot ignore the FERC-mandated costs the middleman must pay:

> "In that situation, for a state ratemaking agency to disregard a FERC-filed rate would clearly be inconsistent with the exclusive federal regulatory scheme over interstate wholesale power prices. The FERC-approved rate at which the middleman purchased power would not be fully recognized as a cost in the retail market, thereby forcing the middleman to sell power at less than its reasonable cost as determined by the federal agency." 476 U.S. at 969.

Moreover, as in *Mississippi Power*, there is no basis for invoking an exception to the filed rate doctrine in order to permit the state to conduct a prudence review. Like the capacity costs at issue in *Mississippi Power*, the FERC-allocated costs at issue here were completely unavoidable by the LDCs. Under orders issued by the FERC, the LDCs were liable to the pipelines for those costs regardless of any action they might take, even if they completely stopped purchasing gas from the pipeline imposing the charge.

In addition to being presently unavoidable, the take-or-pay costs were completely unforeseeable. In the court below, OPC suggested that the Illinois Commerce Commission could properly consider the prudence of the LDCs' past decisions to buy from particular pipelines. The Illinois Supreme Court rejected that argument, on the ground that the LDCs did not know and could not have foreseen that their purchasing decisions would lead to the retroactive imposition of direct-billed take-or-pay costs years later. Until Order No. 436 was issued in 1985, no one knew that long-term take-or-pay contracts would create multi-billion dollar liabilities for the pipelines.[6] And it was not until Order No. 500 was issued in 1987 that the LDCs had any idea whether or how the pipelines' take-or-pay liabilities would be passed on to them. By that time, the purchasing decisions OPC would have the Illinois Commerce Commission review for prudence had long since been made. Thus, as the Illinois Supreme Court recognized, "unless clairvoyance has become an element of prudence, there simply is no basis on which the ICC could conduct a meaningful prudence review." Petn. A31.

The Illinois Supreme Court's determination that there was no basis for a "meaningful prudence review" of direct-billed take-or-pay costs is essentially a finding of fact that this Court need not and should not reconsider. That is particularly true in light of the similar finding by the District of Columbia Circuit. In *Associated Gas Distributors* v. *FERC*, 893 F.2d 349, 356 (D.C. Cir. 1989), *cert. denied*, 111 S.Ct. 277 (1990), the FERC tried to persuade the D.C. Circuit that the purchase deficiency method of allocation did not constitute retroactive rate-making because it had provided advance notice to the LDCs of its intention to use that method in 1984. The court rejected that argument, describing the supposed "hints" the FERC pointed to in a 1984 order as "delphic" and stating that "[t]he Commission can perhaps assume that petitioners [pipelines and LDCs] have some acquaintance with regulatory changes in the natural gas industry, but it cannot require them to be clairvoyant." *Id.*

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[6] Prior to the advent of open access in 1985, the only way (with very limited exceptions) LDCs could obtain natural gas was by purchasing from the interstate pipelines serving their areas. For many LDCs that meant there was no choice at all, since they were physically limited to a single pipeline source for either all or a significant portion of their service territories.

Nantahala and *Mississippi Power* together set forth a bright line test as to how the filed rate doctrine applies to ratemaking decisions by state utility commissions. In this case, the Illinois Supreme Court applied that test properly to the specific facts before it. OPC has not offered any reason in its Petition why this Court should review that decision.

B. Petitioner's Attempts To Distinguish This Case From *Nantahala* And *Mississippi Power* Are Unavailing.

In an attempt to avoid the applicability of *Nantahala* and *Mississippi Power*, OPC argues that the "gas liabilities" at issue here are "purely intrastate in nature" and therefore do not fall under the filed rate doctrine. Petn. at 27-28. *See also* Petn. at 18 ("Take-or-pay liabilities are not FERC-approved allocations of costs or FERC-mandated payments.") This argument is mystifying at best. The pipelines directly billed take-or-pay costs to the LDCs pursuant to mandatory FERC allocations of those costs. Respondents could not avoid paying these FERC-allocated costs. Under these circumstances, it would be difficult to imagine wholesale costs that are more clearly interstate pipeline costs imposed by the FERC. The fact that the Illinois Commerce Commission was setting retail rates within Illinois under which the LDCs would be allowed to recover those FERC-allocated costs does not change the analysis. Indeed, the filed rate doctrine is specifically designed to limit the power of state commissions to fix intrastate retail rates when the state's action would prevent utilities like LDCs from fully recovering all of the costs they are required to pay by FERC orders.

OPC also attempts to evade the filed rate doctrine by arguing that it cannot apply in light of the FERC's suggestion that the LDCs should absorb some portion of the take-or-pay costs allocated to them in order to participate in an industry-wide "sharing" of those costs. At page 34 of its Petition, OPC incorrectly asserts that respondents misled the Illinois Supreme Court with respect to the FERC's intent by suggesting, OPC says, that "it was not clear whether FERC indicated a desire to preempt." In fact, however, the LDCs made the FERC's position absolutely clear to the Illinois Supreme Court, which also had the benefit of all the FERC orders issued on the subject.[7] The Illinois Supreme Court's decision was not based on any misreading or misunderstanding of the FERC's intent. Instead, it was based on the Court's determination that the FERC's intent was wholly irrelevant. That determination was plainly correct.

A federal agency's intent with respect to the preemptive effect of its actions is relevant only in cases where (1) there is no congressional intent to preempt state action in a particular area *and* (2) the proposed state regulation does not in fact conflict with federal regulation.[8] Where Congress acts to make federal jurisdiction over a particular subject matter exclusive, the intent of the agency when it exercises that jurisdiction is wholly beside the point. As this Court stated in *Chevron U.S.A.* v. *Natural Resources Defense Council*, 467 U.S. 837, 842-43 (1984), "[i]f the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress." Similarly, where a federal agency has promulgated regulations, it cannot dispense with the Supremacy Clause merely by saying that it believes inconsistent state regulation is permissible. *See generally Capital Cities Cable, Inc.* v. *Crisp*, 467 U.S. 691, 699 (1984).

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[7] In briefs filed in the Illinois Supreme Court, respondents explained at length the FERC's Order No. 500-H, which was issued on December 13, 1989. *See* 54 Fed. Reg. 52344, FERC Statutes and Regulations ¶ 30,867. In that Order, the FERC reiterated the view it had expressed in Order No. 500 that there should be an "equitable" industry-wide sharing of the cost of discharging the pipelines' take-or-pay liabilities. The FERC also made clear its belief that the LDCs should be forced to "share" by absorbing a portion of those costs rather than passing them on to gas consumers. The FERC suggested various methods that state regulators could use to deny full recovery to LDCs. It also suggested that state regulators could use the same carrot-and-stick approach that the FERC had used with the pipelines: using the delay associated with prudence hearings and the threat of an unfavorable recovery method to persuade the LDCs to "agree" to absorb a portion of the costs in return for guaranteed recovery of the rest.

In this case, if the FERC had chosen to exercise its exclusive jurisdiction over interstate pipeline charges by allowing take-or-pay costs to be included in the price of gas *currently* being sold, state utility commissions could have determined whether LDCs that subsequently elected to purchase gas at prices that included a take-or-pay component had acted prudently in choosing among whatever supply alternatives were available to them. But when the FERC decided instead to eliminate any element of choice by *allocating* take-or-pay costs directly to individual LDCs based on their *past* purchases, it necessarily destroyed the ability of state utility commissions to consider whether those costs had been prudently incurred.

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[8] OPC relies on this Court's decision in *California Coastal Comm'n* v. *Granite Rock*, 480 U.S. 572 (1987), to support its contention that the FERC's views on preemption are controlling. That case, however, involved a situation very different than the case at bar, because Congress did *not* intend in that case to give the federal agency exclusive jurisdiction over the issue in question (environmental regulation of mining in a national forest) and the agency's own regulations assumed that the state would have a role in the permit process.

In short, the Illinois Supreme Court was correct in considering what the FERC *did*, rather than what it said, in determining the preemptive effect of the FERC's allocation of direct-billed take-or-pay costs to the LDCs. Contrary to the argument advanced by OPC, the FERC has no power to waive the preemptive effect it created by the direct allocation of take-or-pay costs to the LDCs, even if the FERC viewed preemption as an obstacle to the proper resolution of the problems created by its own open-access policy.[9]

As this Court held in *Maislin Industries* v. *Primary Steel*, 110 S.Ct. 2759, 2770 (1990), even though a federal agency that is charged with regulating a particular industry segment "has both the authority and expertise generally to adopt new policies when faced with new developments in the industry . . . it does not have the power to adopt a policy that directly conflicts with its governing statute." (citation omitted). In this case, the Natural Gas Act protects LDCs from inconsistent state and federal regulation by prohibiting state utility commissions from second-guessing the reasonableness of costs that the FERC has directly ordered the LDCs to pay. The FERC has no power to withdraw that protection in order to implement a solution that it deems "equitable."

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[9] Significantly, the FERC itself never purported in any of its orders to be making a binding pronouncement on the preemption issue. Indeed, when Order No. 500 was appealed to the District of Columbia Circuit, the FERC specifically stated that it had merely been making suggestions, rather than making a reviewable agency determination with respect to preemption. *See American Gas Association* v. *FERC*, 912 F.2d 1496, 1520 (D.C. Cir. 1990), where the court accepted the FERC's explanation for its statements and concluded that it lacked jurisdiction to review the FERC's position because the only possible injury to the LDCs was that "state agencies might defer excessively" to it.

II. This Case Involves The Application Of A Clear Rule To Particular Facts That Are Not Likely To Recur In The Future.

There are a variety of reasons why this is not a certworthy case. As demonstrated above, the Illinois Supreme Court properly followed this Court's decisions in *Nantahala* and *Mississippi Power*. Moreover, those decisions set forth a clear and unambiguous framework to be used in defining the scope of a state utility commission's power with respect to FERC-approved wholesale rates and allocations. The clarity of the framework established by this Court is confirmed by the fact that there are no conflicts among state supreme courts or in the lower federal courts concerning application of the test set forth in *Nantahala* and *Mississippi Power*.[10]

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[10] Significantly, OPC does not argue that there is any such conflict. In *Kentucky West Virginia Gas Co.* v. *Pennsylvania Public Util. Comm'n*, 862 F.2d 69, 74 (3rd Cir. 1988), the Third Circuit reached the same result as the Illinois Supreme Court did here, holding that under the filed rate doctrine an LDC was entitled to recover the full amount of certain "minimum bill" costs similar to take-or-pay costs, because those costs were unavoidable and had been imposed pursuant to a FERC-approved service agreement. In *New Orleans Public Service, Inc.* v. *The Council of the City of New Orleans*, 911 F.2d 993 (5th Cir. 1990), *cert. granted*, 111 S.Ct. 1617 (1991) ("*NOPSI*"), the Fifth Circuit held that a prudence review could proceed with respect to certain nuclear power plant costs. However, that decision was based on the court's determination that there was some basis for conducting a meaningful pru-

(Footnote continued on following page)

Thus, this case involves simply another application of a clear rule to a particular set of facts. This Court has no reason to inquire into the Illinois Supreme Court's characterization of those facts. That is particularly true since the precise fact pattern involved here is unlikely to arise in subsequent cases. While this case was on appeal, the District of Columbia Court of Appeals struck down the "purchase deficiency" method of allocating take-or-pay costs on the ground that it constituted prohibited retroactive rate-making. *Associated Gas Distributors* v. *FERC*, 893 F.2d 349 (D.C. Cir. 1989), *cert. denied*, 111 S.Ct. 277 (1990). As a result, any cases that may come to the Court in the future concerning recovery of take-or-pay costs at the retail level are likely to involve different facts and therefore may involve different issues as well.[11]

When all of these factors are considered, it is apparent that this is simply not the kind of case this Court should devote its limited resources to reviewing.

III. There Is An Independent State Law Basis For Upholding The Decision In This Case.

In the courts below, respondents argued that Illinois law provided an independent ground for affirming the Illinois Commerce Commission's order. The LDCs argued that there

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[10] *continued*

dence review of the utility's decision to incur the costs in question. Given the directly contrary finding under very different facts by the Illinois Supreme Court in this case, *NOPSI* is readily distinguishable. Furthermore, although this Court has granted the utility's petition for a writ of certiorari in *NOPSI* and is scheduled to hear argument this Term, the parties have indicated that the case may well be settled before argument.

[11] We are not aware of any appellate court cases in other jurisdictions that were decided under the FERC's old method of allocation.

was no basis under Illinois law for requiring them to "share" some arbitrary portion of take-or-pay costs. Under Illinois law, in order to disallow a cost, the Commission must have a basis for deciding that it was improperly incurred.[12] See *The Peoples Gas Light & Coke Co.* v. *Slattery*, 373 Ill. 31, 61-62, 25 N.E. 2d 482, 497 (1939); *City of Chicago* v. *People of Cook County*, 133 Ill. App. 3d 435, 442-443, 478 N.E. 2d 1369, 1374-75 (1st Dist. 1985). Thus, the only basis under Illinois law for disallowing take-or-pay costs would be through a prudence review.

In the court below, the LDCs argued that any prudence review of take-or-pay costs would necessarily be meaningless. Because they could not have predicted that the FERC would ultimately deal with take-or-pay costs as it did, the LDCs could hardly be faulted for failing to take the FERC's 1987 decision into account when they made their purchases during the "comparison periods" of 1983 through 1986. The Illinois Commerce Commission had already found the purchasing decisions made during those years to be prudent, in final orders that were no longer appealable, on the basis of the information available at the time the purchasing decisions were made. The LDCs argued that there was no basis under state law for reopening those decisions many years later for a prudence review by hindsight.

Although the Illinois Supreme Court found it unnecessary to rule on the LDCs' state law arguments in light of its disposition of the federal preemption claim (Petn. at A32), its opinion nevertheless indicates strong sympathy for the LDCs' position with respect to Illinois law. The Court agreed with the LDCs that the allocation of take-or-pay costs under the purchase deficiency method was unforeseeable and therefore that there was simply no basis for a meaningful prudence review by the Illinois Commerce Commission. Thus, even though the Illinois Supreme Court did not rule on the specific issue raised by respondents, its opinion suggests that there would be serious state law issues that would have to be resolved before OPC would be entitled to the relief it has requested, even if OPC were correct on the federal constitutional issue. The existence of this independent state ground to support the ruling below provides yet another reason why this Court should deny OPC's Petition.

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[12] The same standard applies to rate-making decisions by the FERC. Indeed, the reason why the FERC went to such great lengths to encourage pipelines to absorb their share of take-or-pay costs "voluntarily" was that it could not legally require them to do so except by finding that those costs were not prudently incurred.

CONCLUSION

For the foregoing reasons, the Petition for Writ of Certiorari should be denied.

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No. 91-381

IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

THE PEOPLE OF THE STATE OF ILLINOIS
EX REL. THE OFFICE OF PUBLIC COUNSEL,
Petitioner,

v.

THE ILLINOIS COMMERCE COMMISSION, *et al.,*
Respondents.

Petition For Writ Of Certiorari
To The Illinois Supreme Court

BRIEF OF RESPONDENT ILLINOIS COMMERCE COMMISSION IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether the Illinois Supreme court correctly held that Congress' enactment of the Natural Gas Act, 15 U.S.C., § 717 *et seq.* (1987), precludes state regulatory commissions from conducting prudency reviews regarding the pass-through to end-use customers, of direct-billed take-or-pay costs imposed upon local distribution companies by the Federal Energy Regulatory Commission ("FERC").

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CONSTITUTIONAL PROVISION AND STATUTE INVOLVED

The Supremacy Clause of the United States Constitution (U.S. Const., art. VI, cl. 2):

> This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

The Natural Gas Act, § 1(b), (15 U.S.C.A., § 717(b)):

> (b) The provisions of this Chapter shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural gas companies engaged in such transportation or sale, but shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas.

STATEMENT OF THE CASE

On November 22, 1988, the Illinois Commerce Commission ("Commission") entered an order in Commission Docket No. 88-103 establishing the preferred methodology for Local Distribution Company ("LDC") recovery of "take-or-pay" settlement costs billed to them by interstate pipeline companies. *Re Costs Associated with Take-or-pay Charges*, 97 PUR 4th 189 (1988) ("November Order"). In an earlier interim order in this matter concerning the scope of the hearing, the Commission found, *inter alia*, that the "filed rate doctrine" should be applied in the investigation. The filed rate doctrine is a rule of preemption, which requires states to give effect to wholesale rates on file with or approved by the FERC. The Commission found that the filed rate doctrine requires that it permit the recovery of all take-or-pay costs incurred through FERC-approved direct-billed rates. *Re Costs Associated with Take-or-pay Charges*, 95 PUR 4th 5 at 9 (1988), citing *Mississippi Power & Light Co. v. Moore*, 487 U.S. 354, 101 L.Ed 2d 322, 108 S.Ct 2428 (1988); *Nantahala Power and Light Company v. Thornburg*, 476 U.S. 953, 90 L.Ed 2d 943, 106 S.Ct. 2349 (1986); *City of Chicago v. Illinois Commerce Commission*, 13 Ill. 2d 602 (1958).

Take-or-pay clauses are a standard and accepted part of long-term gas purchase agreements between interstate pipelines and their producer-suppliers. The FERC noted in a 1985 policy statement that:

> Contracts for the sale of natural gas have traditionally contained provisions requiring the purchaser to take, or pay for, if tendered by the seller and not taken, some specified quantity of natural gas. (footnote omitted) Typically, the contracts provided for a specified period during which gas paid for could be

> "made up" by the buyer. Indeed, during the 1960's, following a period during which a number of pipelines experienced take-or-pay difficulties, the Commission promulgated a rule in effect requiring a five-year period for jurisdictional sales.

Regulatory Treatment of Payments Made in Lieu of Take-or-pay Obligations, FERC Statutes and Regulations, Regulations Preambles (CCH), ¶ 30,637, p. 31,301 (1985).

Under take-or-pay agreements, pipelines are required to pay for a stated volume of natural gas held by a producer, whether or not that quantity is actually taken by the pipeline in order to serve LDCs. As the Commission noted in its November Order, pipeline take-or-pay problems developed when pipelines were no longer able to maintain historical levels of gas purchases in order to avoid the take-or-pay liability as specified in their contracts with producers. *Re Costs Associated with Take-or-pay Charges*, 97 PUR 4th 189, 192 (1988).

In its November Order, the Commission described four historical events which appear to have caused the take-or-pay problem. First, a nationwide shortage of natural gas took place in the 1970's resulting in many LDCs having to curtail sales of natural gas to end-use customers. Second, as a result of this shortage of natural gas, interstate pipelines sought out new sources of gas and contracted [illegible] substantial volumes of new natural gas from producers. Third, in response to the national shortage of natural gas which was occurring, Congress enacted the Natural Gas Policy Act of 1978, resulting in additional sources of natural gas becoming available, but at higher prices than had been previously charged. Finally, a "gas bubble" or surplus developed which gave rise to the spot gas market which further eroded the market for pipeline sales gas. The foregoing events and factors combined to reduce the pipelines' need to take long term gas supplies from producers. The reduced market for pipeline sales gas led in turn to the take-or-pay problem.

In reaction to these market forces, new supplies of natural gas developed, creating a surplus which allowed both LDCs and large end-use customers of LDCs to bypass interstate pipelines and their suppliers, and purchase natural gas directly from sellers at lower prices on the "spot market." Consequently interstate pipelines saw their take-or-pay liabilities increase as a result of their inability to sell contracted supplies of gas to LDCs.

In response to these developments in the natural gas industry, the FERC issued its Order No. 436, on October 9, 1985. FERC Statutes and Regulations, Regulations Preambles 1982-1985 (CCH), ¶ 30,665 (1985). Order 436 created an open access policy which provided a simplified gas transportation program, allowing LDCs to transport gas over an interstate pipeline without using the pipelines as a wholesaler. The "open access" policy resulted in pipeline customers having greater access to lower cost spot market gas, as an alternative to taking higher priced gas which pipelines had already contracted for with their suppliers. While both LDCs and their customers enjoyed the benefits of lower cost alternative sources of gas, pipeline take-or-pay liability increased because previously contracted gas was not being taken.

On August 7, 1987, the FERC issued its Order 500 dealing with the recovery of take-or-pay liability. FERC Statutes and Regulations, Regulations Preambles 1986-1989 (CCH), ¶ 30,761 (1987). The FERC established two methods for interstate pipelines to pass through to their customers the take-or-pay liabilities. *Id.* at 30,784-85. The first method permitted pipelines to use commodity rate treatment for all take-or-pay costs which the FERC found were prudently incurred. This method allowed pipelines an opportunity to recover 100% of their prudently incurred take-or-pay costs, by adding them to the cost of gas sold in the future. *Id.* at 30,786.

Under the second method of recovery, if a pipeline was willing to absorb between 25% and 50% of its take-or-pay settlement costs, the FERC would presume that an equal amount of take-or-pay settlement costs were prudently incurred and allow recovery of those amounts through direct-billed charges to the pipeline's sales customers. The pipeline's remaining take-or-pay costs were recoverable through a commodity surcharge, or a volumetric surcharge on pipeline throughput. *Id.* at 30,784-85.

The Commission order which is the subject of this appeal was concerned only with the Commission's power to examine LDC actions with respect to the second method: direct billed allocations of take-or-pay settlement costs. As the Commission noted in its November Order, pipelines have uniformly opted for Order 500's direct-billing method of recovery, even though this method guarantees that they will not recover all of their take-or-pay costs.

The direct-billing method, which tends to guarantee the recovery of a minimum of 50% of a pipeline's total take-or-pay settlement expense, was preferable for several reasons. First, the framework of Order 500 discouraged pipeline customers from initiating prudence challenges before the FERC by creating the presumption that direct-billed costs were prudently incurred. Moreover, any party which failed in its efforts to challenge the prudence of these costs was required to pay its allocated share of the actual costs the FERC found prudent. This amount could be twice the amount that the challenger would have paid under the direct-billing methodology. FERC Statutes and Regulations, Regulations Preambles (CCH), ¶ 30,761 at 30,787-88.

FERC Order 500 further required that the costs recovered through direct-billed take-or-pay charges would be allocated among a pipeline's customers based on each customer's contribution to the pipeline's decline in sales before and after "open access" took effect. Customers who took advantage of the lower cost spot market supplies were assigned a higher take-or-pay obligation than those customers who purchased higher priced gas from pipelines with take-or-pay contracts. FERC Statutes and Regulations, Regulations Preambles (CCH), ¶ 30,761 at 30,784-85 (1987).

On July 20, 1988, the Commission issued an "Interim Order" in Commission Docket No. 88-103 finding that under the Supremacy Clause of the Constitution, most recently interpreted by this Court in *Mississippi Power & Light Co. v. Moore*, 487 U.S. 354, 101 L.Ed 2d 322, 108 S.Ct 2428 (1988), the Commission was precluded from conducting a prudency review of direct-billed take-or-pay allocations and that the FERC could not require or authorize such a prudence review by state agencies. *Regarding Costs Associated With Take-or-pay Charges*, 95 PUR 4th 5, 8-9 (1988).

On November 22, 1988, the Commission issued its second order in the docket dealing with the remaining issues presented. The Commission found that take-or-pay charges should be recovered from all classes of customers, including transportation customers, on a uniform volumetric basis. *Re Costs Associated with Take-or-pay Charges*, 97 PUR 4th 189, 197 (1988).

In reaching its decision on these points, the Commission concluded that assessing take-or-pay costs on a volumetric basis was the most accurate way of reflecting the underlying factors which brought about the existence of take-or-pay costs as well as the benefits received from using alternative sources of gas supply. *Re Costs Associated with Take-or-pay Charges*, 97 PUR 4th 189, 197 (1988). The Commission also concluded that the recovery of take-or-pay charges under the mechanism of the Uniform Purchase Gas Adjustment Clause ("UPGA"), allowed under § 9-220 of the Illinois Public Utilities Act, provided the most efficient and effective mechanism for recovering take-or-pay costs, and was a cost of gas under the Illinois Public Utilities Act and the Commission's regulations. *Re Costs Associated with Take-or-pay Charges*, 97 PUR 4th 189, 197-98 (1988). Ill. Rev. Stat. 1987, ch. 111⅔, § 9-220.

OPC appealed the decisions of the Commission to the appellate court. *General Motors Corporation et al. v. Illinois Commerce Commission et al.*, 191 Ill. App. 3d 450 (1990). OPC contended that the Commission was not preempted from reviewing and possibly preventing the passthrough of direct-billed take-or-pay costs. OPC asserted that the Commission should conduct a "prudence review" to determine whether those costs had been properly incurred by the LDCs. In a 2-to-1 decision entered on December 5, 1989, the appellate court reversed the Commission's order. In its opinion, the majority held that the preemption analysis turned on the FERC's intent to preclude state regulatory commissions from considering whether the charges in question should be recoverable in their entirety. Because the FERC had suggested that there should be an "equitable sharing" of take-or-pay costs among the entire industry, including the LDCs, and had stated that state regulatory commissions were free to consider a variety of issues with respect to take-or-pay costs, the majority found no intent on the part of the FERC to compel the states to permit recovery of 100% of those costs by the LDCs. *General Motors Corporation et al. v. Illinois Commerce Commission et al.*, 191 Ill. App. 3d 450, 462 (1990).

The dissenting member of the appellate court panel found no authority for a Commission initiated prudence review of purchasing decisions made by the LDCs. Justice Lund found the FERC's allocation of take-or-pay costs to LDCs to be controlling:

> In our present case, the FERC has determined that take-or-pay power costs, incurred by interstate power suppliers, shall be passed on to the LDCs. The take-or-pay costs have, thus, been determined to be part of the wholesale cost of power by the FERC, and must be allowed by the State utility commissioners as reasonable operating expenses when setting retail prices.

General Motors Corporation et al. v. Illinois Commerce Commission et al., 191 Ill. App. 3d 450, 465 (1990).

Subsequent to the issuance of the appellate court's opinion in this case, the FERC issued its Order 500-H. FERC Order No. 500-H (Dec. 21, 1989), 54 Fed. Reg. 52344, 49 FERC Statutes and Regulations, Regulations Preambles (CCH), ¶ 30,867. In the order, the FERC stated that its decisions regarding take-or-pay allocations are not intended to preempt state review of take-or-pay liabilities incurred by LDCs.

The Illinois Supreme Court reversed the decision of the appellate court. *General Motors Corporation et al. v. Illinois Commerce Commission et al.*, 143 Ill. 2d 407 (1991).

The court found that any reliance on the FERC's intent was misplaced, and that it was Congress' intent in enacting the Natural Gas Act which was controlling. The court further held that the case at bar presented the "classic situation for application of the [filed-rate] doctrine," and held that the filed rate doctrine prohibited the Commission from conducting prudency reviews of direct-billed take-or-pay costs imposed upon local distribution companies by the FERC. *General Motors*, 143 Ill. 2d 407, 423-24.

SUMMARY OF THE ARGUMENT

State agencies are preempted by both the Supremacy Clause and the filed rate doctrine from reviewing the prudency of FERC-allocated, direct-billed take-or-pay costs. Congress' intent to preempt this area is clear. The direct-billed take-or-pay charges at issue in this case involve the rates, charges and allocations of costs associated with providing sales for resale services. These charges clearly fall within the parameters of the FERC's jurisdiction. Moreover, reliance on the intent of the FERC in support of the assertion that the direct-billed take-or-pay charges involved in this case are subject to state prudency reviews is misplaced. The filed rate doctrine is a rule designed to enforce the Supremacy Clause of the Constitution, it is not a rule of deference to the decisions of administrative agencies. It is the intent of Congress which is decisive. In this case, the Natural Gas Act, as interpreted by this Court in the filed rate doctrine, preempts state agencies from reviewing the prudency of these FERC-allocated, direct-billed take-or-pay costs.

REASONS FOR DENYING THE WRIT

The Commission believes that regardless of the intention of the FERC, Order 500 established a rate or charge for natural gas. Order 500 preempts state regulatory agencies, such as the Commission, from altering or denying the pass-through of such costs to LDC customers. The Illinois Supreme Court correctly affirmed the Commission's November Order. The court properly described the issue as being whether the Commission "is preempted from disallowing distributors full recovery, from their customers, of the FERC-*allocated* take-or-pay costs. *General Motors Corporation v. Illinois Commerce Commission*, 143 Ill. 2d 407 at 412 (emphasis added).

The question before this Court is not, as Petitioner argues, whether the Commission is preempted from conducting a prudence review with regard to *all* take-or-pay costs which flow to LDCs from interstate pipelines. Rather, the question is whether the Commission and the Illinois Supreme Court were correct in finding that the Commission was foreclosed from reviewing the prudence of LDC purchasing decisions with regard to direct-billed, FERC-allocated, take-or-pay costs. Petitioner's global arguments improperly expand the scope of review of the Commission's decision with regard to these direct-billed costs.

A reading of the Commission's November Order indicates that the Commission's preemption analysis was confined, both in the July 20, 1988 Interim Order and in the November Order, to recovery of direct-billed, FERC-allocated costs. In contrast, the OPC improperly focuses on the preemption of take-or-pay costs in general. The Commission urges this Court to view the issue at hand in the same narrow manner as did the Commission. The issue is simply whether the Commission can deny LDC recovery of direct-billed take-or-pay charges based on a prudence review of the LDC's purchasing practices. The Commission respectfully submits that the involuntary nature of these direct-billed, FERC-allocated costs, takes them outside the sphere of exceptions to the filed rate doctrine.

The Illinois Supreme Court's decision is entirely consistent with this Court's decisions explaining and applying the "filed rate doctrine." See *Mississippi Power & Light Co. v. Moore*, 487 U.S. 354, 101 L.Ed 2d 322, 108 S.Ct 2428 (1988); *Nantahala Power and Light Company v. Thornburg*, 476 U.S. 953, 90 L.Ed 2d 943, 106 S.Ct. 2349 (1986). For the reasons stated below, the petition for a writ of certiorari should be denied.

I.

STATE AGENCIES ARE PREEMPTED BY BOTH THE SUPREMACY CLAUSE AND THE FILED RATE DOCTRINE FROM REVIEWING THE PRUDENCY OF FERC-ALLOCATED, DIRECT-BILLED TAKE-OR-PAY COSTS.

The preemptive effect of FERC-set allocations is well established and was affirmed by this Court in *Nantahala Power and Light Company v. Thornburg*, 476 U.S. 953, 90 L.Ed 2d 943, 106 S.Ct. 2349 (1986). In that case, the North Carolina Utility Commission had determined that a FERC-set allocation of low-cost Tennessee Valley Authority electric power was too low, resulting in higher electric rates for end-use customers. The North Carolina Commission decided that the company should be imputed to have received a higher allocation of low cost power for purposes of determining its intrastate rates. The North Carolina appellate and supreme courts affirmed that decision.

This Court reversed. Looking first to the filed rate doctrine, this Court stated that federal and state courts are prohibited from reviewing the reasonableness of rates under the jurisdiction of the FERC and its predecessor, the Federal Power Commission ("FPC"), *Nantahala Power & Light v. Thornburg*, 476 U.S. 953, 963-64; 90 L.Ed. 2d 943, 952-53, 106 S.Ct. 2d 2349 (1986). The Court recognized that the filed rate doctrine is not a rule of administrative law designed to ensure that courts respect administrative decisions; rather, it is a matter of the enforcement of the Supremacy Clause of the Constitution. *Nantahala*, 476 U.S. at 963, 90 L.Ed. 2d at 952. Citing the Illinois Supreme Court's decision in *City of Chicago v. Illinois Commerce Commission*, 13 Ill. 2d 607 (1958) with approval, this Court noted that state courts had broadly applied the filed rate doctrine in several contexts where the FERC had established wholesale power prices. *Id.* at 965, 90 L.Ed. 2d at 953. In explaining the rationale behind its decisions and the decision of the various state courts, this Court stated that:

> [O]ur decisions have squarely rejected the view . . . that the scope of FPC jurisdiction over interstate sales of gas or electricity at wholesale is to be determined by a case-by-case analysis of the impact of state regulation upon the national interest. Rather, Congress meant to draw a bright line easily ascertained, between state and federal jurisdiction, making unnecessary such case-by-case analysis. This was done in the Power Act by making FPC jurisdiction plenary and extending it to all wholesale sales in interstate commerce except those which Congress has made explicitly subject to regulation by the States. *FPC v. Southern California Edison Co.*, 376 U.S. 205, 215-216, 11 L.Ed. 2d 638, 84 S.Ct. 644 (1964).

Id. at 966, 90 L.Ed. 2d at 954.

Thus, under the filed rate doctrine, as interpreted by this Court, state utility commissions are precluded from taking actions inconsistent with decisions made by the FERC within its regulatory authority. Specifically, the filed rate doctrine requires that States give effect to rates set by the FERC. *Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571; 169 L.Ed. 856, 101 S.Ct. 2925 (1981).

This Court reaffirmed its view of the filed rate doctrine and the plenary authority granted the FERC in *Mississippi Power & Light v. Moore*, 487 U.S. 354, 101 L.Ed 2d 322, 108 S.Ct. 2428 (1988). In *Mississippi Power & Light*, this Court considered the extent of allowable state commission scrutiny over FERC-set payments by a retail utility to a wholesale utility regulated by the FERC. The Mississippi Supreme Court had held that the state commission erred when it allowed the recovery of the retail utility's FERC-allocated costs, without having first conducted its own review of the prudency of those costs.

In reversing the Mississippi Supreme Court's decision, this Court found that there was no room under the filed rate doctrine for the state commission to make its own determination of reasonable costs once those costs had been established by FERC:

> * * * States may not alter FERC-ordered allocations of power by substituting their own determinations of what would be just and fair. FERC-mandated allocations of power are binding on the States, and States must treat those allocations as fair and reasonable when determining retail rates.

Mississippi Power & Light, 487 U.S. 354, 371, 101 L.Ed. 2d 322, 338 (1988).

As discussed previously, prior to its decision in this case, the Illinois Supreme Court had also recognized the preemptive effect the NGA has upon the Commission's ability to set natural gas rates in a case cited with approval by this court in *Nantahala*. *City of Chicago v. Illinois Commerce Commission*, 13 Ill. 2d 607 (1958); See *Nantahala*, 476 U.S. at 963, 90 L.Ed. 2d at 952. In *City of Chicago*, review of a Commission order was sought which allowed Peoples Gas Light and Coke Company, an Illinois LDC, to automatically adjust its rates to reflect changes in wholesale rates established by the FPC. The City of Chicago had contended that because Peoples Gas received its wholesale gas from two subsidiaries, the Commission was required to review the reasonableness of the Federal Power Commission-approved rates charged for that gas. The Illinois Supreme Court held that:

> [t]he Natural Gas Act of 1938, (Citation omitted) vested the power to fix rates for natural gas transported and sold to distributing companies in interstate commerce exclusively in the FPC and preempted any right which might have existed in the States to regulate such rates. (Citations omitted). [The Subsidiaries] must charge and Peoples must pay the FPC determined rate, and the Commission has no power over such rate.

City of Chicago v. Illinois Commerce Commission, 13 Ill. 2d 607, 614 (1958).

A. The take-or-pay liabilities involved in this case are FERC-mandated.

In an effort to circumvent this overwhelming authority, the OPC states that "[t]ake-or-pay liabilities are not FERC-approved allocations of costs or FERC-mandated payments." OPC Petition, p. 18. Rather, the OPC asserts, "the issue is intrastate and is tied to FERC only through the policy statements issued by the FERC directing the states to allocate take-or-pay costs across all segments of the industry." *Id.* The OPC describes the Illinois Supreme Court's decision in this matter as being inconsistent with the preemption doctrine. None of the OPC's arguments are supportable or invite further judicial scrutiny.

OPC's assertion that direct-billed amounts allocated to an LDC and ordered to be paid by that LDC are neither an allocation of costs nor a mandated payment strains the imagination. It begs the question of whether the LDC has any choice to avoid the charge. The OPC has offered no theory of law which would indicate that once the FERC validly allocates a portion of an interstate pipeline's take-or-pay burden directly to a particular LDC that the LDC's payment of that allocated amount is either elective or avoidable.

B. The law of preemption is directly applicable to the take-or-pay costs involved in this case.

While the Commission agrees that states are only preempted by federal agency action in particular circumstances (see OPC Petition, p. 19), the Commission believes that the situation presented by this case is the precise situation contemplated by the filed rate doctrine. As the OPC recognizes, there are only three circumstances in which federal law may preempt state law. One of these is present here; where Congress has given a federal agency complete and plenary authority over an area of regulation. In such an instance, it is the intent of Congress, and not the interpretation of the agency, which must be given effect by the courts.

The Commission respectfully suggests that the case of *Kentucky West Virginia Gas Company v. Pennsylvania Public Utility Commission*, 837 F.2d 600 (3rd Cir. 1988) demonstrates the proper purpose and focus of prudency reviews conducted by state commissions, as well as delineating the respective spheres of authority possessed by state and federal agencies. There, an LDC challenged the state commission's refusal to allow the recovery of the costs of gas purchased, based upon the conclusion that the utility was imprudent in not purchasing lower cost gas which was available at the time of purchase. The utility contended that because the cost of the higher cost gas was approved by FERC, the state commission was preempted from inquiring into its purchase decision. *Kentucky West Virginia Gas Company v. Pennsylvania Public Utility Commission*, 837 F.2d 600, 605.

The court rejected this contention, finding that while state commissions were clearly preempted from questioning or altering FERC rates which established the costs of gas, it was within the authority of the commission to inquire into, and deny the recovery of higher cost gas purchased, where other sources of lower cost gas were available. *Kentucky West Virginia Gas Company v. Pennsylvania Public Utility Commission*, 837 F.2d 600, 609.

This Court in *Mississippi Power & Light*, clearly recognized that the ability of a retail utility, such as an LDC, to exercise some choice in its purchase practices is the demarcation point between FERC authority under the filed rate doctrine, and that of a state commission operating under its own authority. This Court stated that:

> As we assumed [in *Nantahala*], it might well be unreasonable for a utility to purchase unnecessary quantities of high cost power, even at FERC-approved rates, *if it had the legal right to refuse to buy that power*. But if the integrity of FERC regulation is to be preserved, it obviously cannot be unreasonable for MP&L to procure the particular quantity of high-

> priced Grand Gulf power that FERC has ordered it to pay for. 101 L.Ed. 2d at 340. (Emphasis added).

Pursuant to § 9-220 of the Illinois Public Utilities Act, Ill. Rev. Stat. 1987, ch. 111⅔, § 9-220, annual reconciliation hearings take place at which time each Illinois LDC is required to establish the prudency of its purchase practices during the year under review. In order for this hearing to be meaningful in any sense, the prudency of a utility's purchase practices must focus only upon those costs concerning which the utility had the opportunity or choice to make a lower cost purchase.

The pass-through of take-or-pay costs in the present case, however, does not involve an issue or question of choice by the LDCs in their purchase practices. As distinct from the question of choice in gas purchases, the challenge made in this case is that some portion of the take-or-pay charges properly imposed on LDCs by the Order 500 allocation can be denied recovery from end-use customers. Such a challenge is clearly directed to the rate or charge imposed by FERC, and is prohibited by the filed rate doctrine, as set forth in *Mississippi Power & Light v. Moore*, 487 U.S. 354, 374, 101 L.Ed. 2d at 340.

C. Congress intended to preempt this area as it involves the rates, charges and allocations of costs associated with providing sales for resale services.

The OPC argues that the legislative history of the NGA shows that the Congress expressed no intent to preempt states in cases such as this, and that Congress did not intend to occupy the whole of natural gas regulation. OPC Petition, p. 20. These conclusions are purportedly gleaned from the fact that the Congress, in enacting the NGA, left certain admittedly interstate functions to state regulation. For example, with regard to the interstate sale of gas, the Congress only chose to regulate sales for resale.

At the time the NGA was enacted, the states had been prohibited by the United States Supreme Court from regulating interstate pipelines because of the Commerce Clause. In enacting the NGA, the Congress intended to create a comprehensive scheme of regulation that would be complementary in its operation to that of the states, without any confusion of functions. *Public Utilities Commission of Ohio v. United Fuel Gas Company*, 317 U.S. 456 (1943). The chief purpose of the NGA was to secure regulation of the transporter and large scale seller in interstate commerce. *Mississippi River Fuel Corporation v. Federal Power Commission*, 121 F.2d 159 (1941).

The Natural Gas Act contemplated a dual system of regulation. The purpose of Congress in enacting the NGA was to occupy the field in cases where courts had found the states unable to act so that there would be no gaps in regulation. *See Interstate Natural Gas Co. v. Federal Power Commission*, 331 U.S. 682 (1947). Section 1 of the NGA enumerated the scope of the FERC's jurisdiction. Generally, federal regulation applies to the transportation of natural gas in interstate commerce but not to any other transportation. It applies to the sale in interstate commerce of natural gas for resale for ultimate public consumption but not to the local distribution of natural gas. The law in this regard is clear; the Commission is preempted from regulating interstate sales for resale. Thus, costs directly allocated to an LDC arising from pipeline maintenance of inventories to meet responsibilities for their sales for resale customers clearly fall outside the ambit of state regulation insofar as the LDC has no choice but to pay a specific allocated share of those costs.

To reiterate, the question is not whether the Congress intended to occupy the entire field of natural gas regulation but whether it intended to occupy the portions of the field at issue in this case, i.e., rates, charges and allocations of costs associated with providing sales for resale services. The law in this area, as established by this Court, amply demonstrates that Congress indeed intended to preempt the regulation of sales for resale. Take-or-pay charges are the direct result of pipeline cost of providing sales for resale services. The FERC has recognized as much by stating in Order 500 that:

> . . . It is true that the Commission's current policy, and one of the flowthrough mechanisms found acceptable in this rule, is that take-or-pay buyout and buydown costs are expenses related to the acquisition of gas supplies and should therefore be classified as production related and recovered through the pipeline's commodity rates.

FERC Statutes and Regulations, Regulations Preambles (CCH), ¶ 30,761, p. 30,786.

OPC's fixation on Congress' partial preemption of the entire natural gas field should not be allowed to obscure the fact that sales for resale and charges associated with those sales, are under the sole jurisdiction of the FERC.

States are not allowed to interfere with FERC's plenary authority over interstate wholesale rates. *Mississippi Power & Light Co. v. Moore*, 487 U.S. 354, 101 L.Ed 2d 322, 108 S.Ct. 2428 (1988); *Nantahala Power and Light Company v. Thornburg*, 476 U.S. 953, 90 L.Ed. 2d 943, 106 S.Ct. 2349 (1986). The lesson of these cases is clear: states are not allowed to "trap" costs found by the FERC to be reasonable, by denying LDC's the right to recover them from their ratepayers. To adopt the OPC's position could result in just such a "trapping" of costs. Therefore, OPC's assertions must be rejected.

II.

THE FILED RATE DOCTRINE IS A RULE DESIGNED TO ENFORCE THE SUPREMACY CLAUSE OF THE CONSTITUTION, IT IS NOT A RULE OF DEFERENCE TO THE DECISIONS OF ADMINISTRATIVE AGENCIES.

Finally, the OPC contends that the Illinois Supreme Court's decision in this matter is inconsistent with this Court's decisions which speak to a federal agency's power to declare its intention in the area of preemption. OPC Petition, pp. 38-43. OPC continues to place importance on the reasoning of the Illinois appellate court, which was rejected by the Illinois Supreme Court. See, *General Motors Corporation et al. v. Illinois Commerce Commission et al.*, 191 Ill. App. 3d 450, 462 (1990); *General Motors Corporation v. Illinois Commerce Commission*, 143 Ill. 2d 407, 421 (1991). Without inquiring into whether the FERC's interpretation was a correct one, the appellate court simply concluded that the FERC's interpretation was reasonable and followed it without further analysis.

By taking the FERC's opinion as to the effect of its orders at face value, the appellate court and the OPC misapprehend this Court's decision in *Nantahala*. Rather than treating the issue as one of enforcement of the Supremacy Clause, as required by *Nantahala*, the appellate court and the OPC relegate the filed rate doctrine to a rule of deference to the decisions of administrative agencies; the very rationale that was specifically rejected in *Nantahala*, 476 U.S. at 963, 90 L.Ed. 2d at 952. In addition, having ignored Congress' intent to give the FERC plenary authority in the field of natural gas rates, as interpreted by the courts in the filed rate doctrine, the court and the OPC engage in the very same case-by-case analysis this Court rejected in *FPC v. Southern California Edison*, 376 U.S. 205, 215-216, 11 L.Ed. 2d 638, 84 S.Ct. 644 (1964). A proper analysis of the preemption issue in this case cannot begin and end with the FERC's intent as expressed in its orders. It is the intent of Congress which is relevant, and in this case Congress intended to preclude state regulatory commissions from conducting prudency reviews regarding the pass-through to end-use customers of costs, such as these direct-billed take-or-pay costs, imposed upon local distribution companies by the FERC.

CONCLUSION

WHEREFORE, the Illinois Commerce Commission prays that this Court deny the petition for a writ of certiorari.

Respectfully submitted,

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No. 91-381

IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

THE PEOPLE OF THE STATE OF ILLINOIS
ex rel.* THE OFFICE OF PUBLIC COUNSEL *et al.
Petitioners,

v.

THE ILLINOIS COMMERCE COMMISSION *et al.*
Respondents.

Petition For Writ Of Certiorari
To The Illinois Supreme Court

REPLY TO BRIEFS IN OPPOSITION TO THE OFFICE OF PUBLIC COUNSEL'S PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether the Illinois Supreme Court correctly held that the Illinois Commerce Commission is preempted by the Sixth Amendment's Supremacy Clause and the Natural Gas Act's filed rate doctrine from allocating take-or-pay gas costs between local segments of the gas industry even after the Federal Energy Regulatory Commission determined that states were to implement its allocation policy pursuant to the Natural Gas Act. United States Constitution, U.S. Const., Art. VI, cl. 2 (Petit. at A136); Natural Gas Act, 15 U.S.C. Sect. 717 et seq. (1988) (Petit. at A136).

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No. 91-381

In The

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October Term, 1991

THE PEOPLE OF THE STATE OF ILLINOIS
ex rel. THE OFFICE OF PUBLIC COUNSEL *et al.*
Petitioners,

v.

THE ILLINOIS COMMERCE COMMISSION *et al.*
Respondents.

**Petition For Writ Of Certiorari
To The Illinois Supreme Court**

REPLY TO BRIEFS IN OPPOSITION TO THE OFFICE OF PUBLIC COUNSEL'S PETITION FOR WRIT OF CERTIORARI

REASONS FOR GRANTING THE WRIT

The Illinois Supreme Court improperly ruled that the Illinois Commerce Commission ("Commission" or "ICC") is preempted by the Supremacy Clause of the United States Constitution, U.S. Const., Art. VI, cl. 2, and the filed rate doctrine from allocating take-or-pay costs to all segments of the gas industry as intended by the Federal Energy Regulatory Commission ("FERC"). *General Motors Corp. v. Illinois Commerce Commission*, 143 Ill. 2d 407, 574 N.E. 2d 650 (1991). This is a case in which a petition for certiorari should be granted. FERC's Order 500 does not establish a FERC-mandated rate that can be described in any way as a filed rate. The take-or-pay charges at issue are not subject to the exclusive jurisdiction of Federal Energy Regulatory Commission. Moreover, FERC Order 500 does not preempt state regulatory agencies from altering or denying the pass-through of take-or-pay liabilities to LDCs. Finally, because Congress has not expressed an intent to occupy the entire field of natural gas regulation, FERC's intent regarding the preemptive effect of its actions is entitled to deference.

The question presented to this Honorable Court is whether the ICC is preempted by the Supremacy Clause and the filed rate doctrine from implementing the intent of FERC to allocate take-or-pay gas costs between local segments of the gas industry. This statement of the issue and the related discussions in the Petition for Certiorari do not "improperly expand the scope of review of the [ICC]'s decision" with regard to take-or-pay charges in Illinois. Brief of the ICC at 11. The question before this Court is not, as Respondents argue, limited to whether the ICC is foreclosed from reviewing the prudence of the LDC purchasing decisions with regard to direct-billed, FERC-allocated, take-or-pay costs. *Id.* Rather, the appropriate focus is on the preemption analysis and the stated intention of FERC not to preempt take-or-pay allocation at the state level.

Moreover, the filed rate doctrine as applied by this Court in *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953, 106 S.Ct. 2349, 90 L.Ed. 2d 943 (1986) and *Mississippi Power & Light Co. v. Mississippi*, 487 U.S. 354, 108 S.Ct. 2428, 101 L.Ed. 2d 322 (1988) does not preempt state commissions from allocating take-

or-pay liabilities pursuant to orders of FERC. Thus, the Illinois Supreme Court's reliance on those cases is misplaced.

I. United States Supreme Court Case Law

A. *Nantahala* and *Mississippi Power* Are Not Applicable

Respondents rely on *Nantahala* and *Mississippi Power* for the proposition that the ICC is precluded from allowing anything but full recovery by the LDCs of their take-or-pay liabilities to their interstate pipeline suppliers. Northern Illinois Gas et al. at 9; ICC at 12; Interstate Power et al. at 7. However, both cases are clearly distinguishable from the case at bar. The parties submit that the liabilities in question are rates to which the filed rate doctrine is applicable. However, even assuming the filed rate doctrine could apply, neither *Nantahala* nor *Mississippi Power* bring this situation within the ambit of the filed rate doctrine. In both cases, there was a readily apparent intention *on the part of FERC* to preempt state regulators from reallocating FERC-approved cost allocations. This Court merely gave effect to that intention. In the instant case, FERC orders established mechanisms for pass-through of pipeline take-or-pay buyout and buy down gas liabilities. There is no intention on the part of FERC to preempt state regulators from allocating charges.

Nantahala concerned an attempt by the North Carolina Utilities Commission to alter a FERC determined allocation of costs between two related utility companies. This Court held that the North Carolina Commission's action was preempted since it interfered with FERC's plenary authority over wholesale rates. The interference or conflict resulted from the North Carolina Commission's attempt to impute more low-cost electricity than was used by FERC to calculate its wholesale rate.

Mississippi Power involved the Mississippi Public Service Commission's determination as to whether it could review the prudence of management decisions to incur costs associated with the Grand Gulf nuclear power plant in light of a FERC opinion which allocated the capacity costs among the multi-state members of the nuclear power plant holding company, Middle South Utilities. This Court determined that the FERC proceedings preempted a prudence inquiry by the Mississippi Commission. Furthermore, it was determined that the proposed prudence inquiry would conflict with the authority of the FERC since the federal agency could have addressed prudence if it had been raised.

Both cases involved FERC's establishment of rates that were based upon a determination of entitlements of power. The states had attempted to establish retail rates based upon different assumptions of power entitlement. Clearly, in these cases, the assumption of different entitlements would affect the determination of rates, since different fixed costs would be allocated. Thus, the Court found that the filed rate doctrine controlled since the states were interfering in FERC's clear statutory ability to establish wholesale rates based upon cost of service. The determination of entitlements and the allocation of capacity costs in the two cases were an integral part of that determination.

In the instant case, however, *FERC had no jurisdictional ability to order or establish the sharing of take-or-pay costs by local state distribution companies in its sharing proposal.* FERC expressly noted the fact that its sharing policy was intended to apply to LDCs, but that it did not have the jurisdiction to accomplish this cost allocation. FERC Order No. 500, 89 PUR 4th at 331. Thus, the filed rate doctrine cannot apply since the predicate for its application, i.e. FERC jurisdiction, does not exist.

B. Federal Legislation Does Not Completely Occupy The Field of Natural Gas Regulation

More generally, the Office of Public Counsel ("OPC") is not arguing that the FERC's and the states' rights are concurrent as proposed by the Interstate Power et al. in its Brief at 5-6, ICC Brief at 18. Rather, the OPC is arguing that in enacting the Natural Gas Act ("NGA"), 15 U.S.C. Section 171 et seq. (Petit. at A136), Congress did not intend to preempt states in cases such as the one before this Court. It has been well settled that any subject area not reserved to the Federal government's jurisdiction allows preexisting state power to be undisturbed. *FPC v. Southern California Edison Co.*, 376 U.S. 205, 213, 215, 84 S.Ct. 644, 650-51, 11 L.Ed. 2d 638 (1964). Indeed, relatively few areas have been found to be fully occupied by Federal government regulation, to the exclusion of state regulation. *Zschernig v. Miller*, 389 U.S. 429 (1968), *reh'g den.*, 390 U.S. 974 (1968).

This Court has spoken on the issue of Federal versus state jurisdiction of natural gas and found that Federal regulatory authority is not exclusive. In *Panhandle Eastern Pipe Line Co. v. Public Service Comm'n of Indiana*, it was held that "in no manner" was the Natural Gas Act to "usurp" state authority. 332 U.S. 507, 520, 68 S.Ct. 190, 197, 92 L.Ed. 128 (1947).[1] "The Natural Gas Act created an articulate legislative program based on a clear recognition of the respective responsibilities of the federal and state regulatory agencies." *Id.* Additionally, in *FPC v. Panhandle Eastern Pipe Line* this Court stated, "[n]either state nor federal regulatory body was to encroach upon jurisdiction of the other." 337 U.S. 498, 513, 69 S.Ct. 1251, 1260, 93 L.Ed. 1499 (1949). The clear intent of Congress in enacting the Natural Gas Act was to "supplement" state regulatory power so to promote "harmonious and comprehensive regulation of the industry." *Id.*

II. Federal Agencies Are Empowered To Determine The Effect Of An Enabling Statute

A. A Federal Agency's Interpretation Of Its Enabling Statute Is Central To A Preemption Analysis

A federal agency's intent with respect to the preemptive effect of its actions is relevant in cases where (i) there is no congressional intent to preempt state action in a particular area, and (ii) the proposed state regulation does not in fact conflict with federal regulation. *Arkansas Electric Cooperative v. Arkansas Public Service Comm'n*, 461 U.S. 375, 384, 103 S.Ct. 1905, 1912, 76 L.Ed. 2d 1 (1983). *See* Petition at 19; Northern Illinois Gas Co. et al. Brief at 15; ICC Brief at 4. Where Congress does not act to make federal jurisdiction over a particular subject matter exclusive, such as in the area of natural gas regulation, the intent of the agency exercising that jurisdiction becomes the focus of the federal preemption discussion. *Chevron U.S.A. v. Natural Resources Defense Council*, 467 U.S. 837, 842-43, 104 S.Ct. 2778,

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[1] "The jurisdiction granted to the Federal Power Commission by the Natural Gas Act necessitates close correlation with state regulatory bodies." *Panhandle Eastern*, 332 U.S. at 520, 68 S.Ct. at 190. (Footnote N. 18)

2782 (1984). Respondents argue that Congress has fully occupied the field of natural gas regulation to the exclusion of the states such that state commissions are preempted from acting. However, many sales of gas have numerous components which allow federal and state jurisdiction to be interlocking. *Public Utilities Comm'n of State of Cal. v. FERC*, 900 F.2d 269, 274 (D.C. Cir. 1990). Thus, it is important for the Federal authority to clarify its role in particular areas not specifically addressed by Congress.

Where an order of a Federal agency is needed to implement its authority, a Federal agency can interpret its own enabling statute to set-out the parameters of its jurisdiction. (i.e. allow an equitable sharing). It has long been held by this Court that if Congress has explicitly left a gap for the Federal agency to fill, there is an express delegation of authority to the agency to elucidate a specific provision of the statute by regulation. "The power of an administrative agency to administer a congressionally created . . . program necessarily requires the formulation of policy and the making of rules to fill any gap left, implicitly or explicitly, by Congress." *Morton v. Ruiz*, 415 U.S. 199, 231, 94 S.Ct. 1055, 1072, 39 L.Ed. 2d 270 (1974). Such legislative regulations are given controlling weight unless they are arbitrary, capricious, or manifestly contrary to the statute. *See U.S. v. Morton*, 467 U.S. 822, 834, 104 S.Ct. 2769, 2776, 81 L.Ed. 2d 680 (1984). In certain circumstances the delegation by the legislature is implicit, rather than explicit. In this circumstance, the court may not substitute its own construction of a statutory provision for a reasonable interpretation made by the agency. *INS v. Jong Ha Wang*, 450 U.S. 139, 144, 101 S.Ct. 1027, 1031, 67 L.Ed. 2d 123 (1981).

When reviewing a Federal agency's interpretation of its enabling statute, the reviewing court should give an administrative agency considerable deference, even though the case might be characterized as involving a limit on the agency's jurisdiction. *The Business Roundtable v. SEC*, 905 F.2d 406, 408 (1990), *citing*, *Chevron USA*, 467 U.S. 837, 104 S.Ct. 2778, 81 L.Ed. 2d 694 (1984). As this Court stated in *Mississippi Power*: "it is plain that giving deference to an administrative interpretation of its statutory jurisdiction or authority is both necessary and appropriate." 487 U.S. 354, 108 S.Ct. at 2444, 101 L.Ed. 2d 322 (1988). Therefore, Federal agencies clearly have the power to set policy concerning the effect of their interpretation of its own enabling statute.

B. FERC's Policy Regarding Take-Or-Pay Liabilities Are Not Orders Mandating FERC Filed Rates

Take-or-pay liabilities are not FERC-mandated, nor FERC-approved costs which are subject to the preemptive effect of the filed rate doctrine. The filed rate doctrine, contrary to the assertions of Respondents, has no effect on take-or-pay liabilities. Brief of Interstate Power et al. at 7; Brief of ICC at 15-16; Northern Illinois Gas et al. at 14. As a general rule, FERC wholesale rates are costs that must be recovered pursuant to the filed rate doctrine. However, the filed rate doctrine is not controlling in this case because FERC's policy orders regarding take-or-pay charges were policy orders directing local, state commissions to allocate liabilities at the state level.[2] Contrary to Respondents' arguments, take-or-pay costs are not traditional wholesale purchased gas costs. FERC designated take-or-pay costs as gas charges, not payments for gas, so that state commissions could allocate the liability to all segments of the industry. Significantly, take-or-pay costs are not payments for the purchase of gas, but, rather, payments for the failure to purchase gas. *Diamond Shamrock Exploration Co. v. Hodel*, 853 F.2d 1159 (5th Cir. 1988).

The costs in question are clearly not purchased gas costs which would be subject to the filed rate doctrine. Respondents have cited nothing to bolster their argument that FERC's policy statements pertaining to take-or-pay costs were regarded by FERC to be statements concerning traditional wholesale purchased gas costs. In fact, FERC made it abundantly clear that its Order No. 500 take-or-pay liability mechanism was to be characterized as costs which were not subject to the filed rate doctrine. FERC Order No. 500, 89 PUR 4th 313, 326 (1987). Indeed, take-or-pay charges have not been treated or considered part of purchased gas cost proceedings. They have been treated as a separate item apart from purchase gas cost cases. 18 C.F.R. Section 2.76(b) (1988). Thus, the Federal agency charged with the responsibility for the regulation of gas level, expressly noted that these costs are not purchased gas costs subject to Federal preemption.

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[2] FERC fully expected state commissions to have authority to consider take-or-pay cost allocation questions at the state level. FERC explained that state commissions would not be hindered by the filed rate doctrine in their efforts to allocate take-or-pay liabilities at the state level:

> Several state commissions also express concern over the Commission's reference to *Nantahala Power and Light Co. v. Thornburg*, 476 U.S. 953, 90 L. Ed. 2d 943, 106 S.Ct. 2349 (1986).
>
> . . .
>
> The Commission does not believe that *Nantahala* precludes state regulators from designing LDC rates, or, in appropriate circumstances from reviewing the prudence of LDCs' purchasing decisions insofar as they effect take-or-pay costs. Order No. 500 at 331.

Moreover, the Fifth Circuit Court of Appeals has determined that take-or-pay costs are not payments for the sale of gas. *Diamond Shamrock*, 853 F.2d 1159, 1167 (5th Cir. 1988). Specifically, the court rejected the attempt of the federal government to recover royalty payments on take-or-pay settlements finding that such settlements did not represent payments for the gas. As the court stated:

> Take-or-pay payments are not . . . payments for the sale of gas. Far from being payments for the purchase of gas, take-or-pay payments are payment for the pipeline-purchaser's *failure* to purchase (take) gas.

Id. at 1167. Payments for the sale of gas are normally rates which are on file with FERC. It is clear, however, that these costs are not current costs of purchasing gas for the pipelines. Thus, since these charges are not payments for the sale of gas, it is correct to conclude that take-or-pay charges are not preempted because these charges are not filed rates with FERC. Therefore, the filed rate doctrine has no effect. These liabilities can be allocated at the state level because FERC classified these charges as non-current costs.

III. There Is An Independent State Law Basis To Conduct A Meaningful Prudence Review

Respondents claim the Illinois Supreme Court suggested that "there would be serious state law issues that would have to be resolved before OPC would be entitled to the relief requested." *Id.* at 21. This is not the case at all. The Illinois Supreme Court did not rule on this issue whatsoever. Moreover, Respondents neglect to refer to the Illinois Appellate Court's ruling which ordered a remand of the proceeding to the ICC. The court stated, "[a]t the proceedings following remandment of this cause, the ICC is to admit evidence pertaining to (a) the sharing of the take-or-pay costs of LDC's between the LDC's and ratepayers and (b) the factors relevant to the prudence of the past purchasing practices of the LDC's as they relate to take-or-pay costs." (Petition at A64).[3] Indeed, if the Illinois Supreme Court truly believed it could not decide the issue because there was no state law basis to conduct a prudence review, as was argued by the Respondents, the court would not have addressed the preemption issue at all.

The Commission could make an allocation based upon general risk sharing. This Court approved risk sharing practices by state commissions in *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 312, 102 L.Ed. 2d 646, 660, 109 S.Ct. 609 (1989). Moreover, the ICC approved a risk sharing methodology in Central Illinois Light Company, ICC Docket 83-0177, at 11-13 & 15, Cancellation of Duck Creek II. Risk sharing could be made regardless of the prudence practices of an LDC because all segments of the gas industry were intended by FERC to share the cost of take-or-pay liability. As discussed in the OPC's Petition for Certiorari, FERC noted numerous reasons for the development of the take-or-pay liability, and few if any of those reasons were the fault of any single party in the gas industry. Thus, FERC concluded, there should be an equitable sharing between producers, pipelines, LDCs and consumers.

The Commission can also make an allocation of these take-or-pay costs following a prudence review of LDC purchasing decisions. The Respondents' argument that a state commission prudence review would be meaningless is merely a final effort by them to divert this Court's attention from the central issue. The fact that the LDCs could not predict FERC would issue policy orders regarding take-or-pay liabilities is of little consequence. Brief of Northern Illinois Gas et al. at 20. The LDCs were making purchasing decisions pertaining to take-or-pay contracts long before the issuance of the FERC orders. FERC's orders were a response to, not a precursor of, take-or-pay liabilities. A prudence review by a state commission would focus on the LDC decision to purchase gas on the spot market and not from the pipelines, thereby exposing the LDC to take-or-pay liability. Thus, the prudence review would be meaningful.

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[3] Due to the ICC's decision pertaining to the applicability of the preemption and filed rate doctrines, the ICC struck testimony of Witness Mr. Rosenberg regarding the sharing of take-or-pay costs between LDCs and ratepayers. Additionally, factors pertaining to a prudence review of past purchasing practices of LDCs were also struck. (Petitioner A43).

CONCLUSION

For the foregoing reasons, the Petition for Writ of Certiorari of the Illinois Office of Public Counsel should be granted.

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No. 91-381

In the Supreme Court of the United States

OCTOBER TERM, 1991

PEOPLE OF THE STATE OF ILLINOIS ex rel.
OFFICE OF PUBLIC COUNSEL, PETITIONER

v.

ILLINOIS COMMERCE COMMISSION

*ON PETITION FOR A WRIT OF CERTIORARI
TO THE ILLINOIS SUPREME COURT*

BRIEF FOR THE UNITED STATES AND THE FEDERAL ENERGY REGULATORY COMMISSION AS AMICI CURIAE

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QUESTION PRESENTED

Acting pursuant to the Natural Gas Act, 15 U.S.C. 717 *et seq.*, the Federal Energy Regulatory Commission authorized interstate gas pipelines to recover from their customers a portion of the amounts the pipelines have paid to settle liability under take-or-pay provisions in their contracts with gas producers. In proceedings before the Illinois Commerce Commission, the pipelines' customers sought to pass through, to their retail customers, the amounts FERC's orders allowed the pipelines to recover. The question presented is:

Whether principles of federal preemption—in particular, the filed rate doctrine—obligate the Illinois Commerce Commission to allow the pipelines' customers to pass through the full amount of the take-or-pay charges imposed on them.

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In the Supreme Court of the United States

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PEOPLE OF THE STATE OF ILLINOIS ex rel.
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BRIEF FOR THE UNITED STATES AND THE FEDERAL ENERGY REGULATORY COMMISSION AS AMICI CURIAE

This brief is submitted in response to the Court's order inviting the Solicitor General to file a brief expressing the views of the United States.

STATEMENT

1. *FERC's Jurisdiction Under the Natural Gas Act*

Under Section 1(b) of the Natural Gas Act, 15 U.S.C. 717(b), the Federal Energy Regulatory Commission (FERC) exercises exclusive regulatory authority over

> the transportation of natural gas in interstate commerce, * * * the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and * * * natural-gas companies engaged in such transportation or sale * * *.

The Act preserves state authority over "any other transportation or sale of natural gas," "the local distribution of natural gas," "the facilities used for such distribution," and "the production or gathering of natural gas." *Ibid.*

2. *FERC's Open-Access Policy*

In the 1980s, FERC exercised its authority to promote a major restructuring of the natural gas industry. Before that time, most natural gas was sold by producers to gas pipelines and then was resold by the pipelines to local distribution companies (LDCs), which serve consumers and industrial users, or to other pipelines or end users. LDCs were usually unable to purchase gas directly from producers. Many geographic areas were served by only a single pipeline, and a pipeline holding such a market position was generally unwilling to transport natural gas in competition with its own sales.

In 1985, however, FERC issued its Order No. 436.[1] The objective of the order was to facilitate "open access" to all interstate pipelines, so that LDCs and others could purchase natural gas directly from producers and employ the pipelines to transport it. FERC's primary goal was to increase the extent to which natural gas sales were exposed to market forces. The open-access policy generally had its intended effect. When Order No. 436 was issued, there was a surplus of natural gas at the wellhead—resulting from the phased deregulation of wellhead prices under the Natural Gas Policy Act of 1978, 15 U.S.C. 3301 *et seq.*, and other economic factors. LDCs and others were able to contract for those supplies directly with gas suppliers on the "spot market" and engage pipelines to transport the gas. Wholesale customers (such as LDCs) of the pipelines were thus able to realize the benefits of increased access to competitively priced supplies.

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[1] Order No. 436, *Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, 50 Fed. Reg. 42,408 (1985).

One consequence of those changes in the natural gas industry, however, was that many gas pipelines were faced with major liabilities under "take-or-pay" clauses in their contracts with natural-gas producers. A take-or-pay clause obligates a pipeline to pay for a certain amount of gas at a specified price, even if the pipeline does not actually take delivery of the gas. See *Transcontinental Gas Pipe Line Corp.* v. *State Oil & Gas Bd.*, 474 U.S. 409, 412 (1986). Between 1977 and 1982, when the price of natural gas was much higher than it is today and supplies were tight, many pipelines agreed to take-or-pay clauses in order to secure access to supplies sufficient to serve the anticipated demand of their customers.

As a result of the increased supplies and lower prices prevalent in the market by the mid-1980s, pipelines' customers—principally LDCs—had little incentive to purchase gas from pipelines at prices sufficient to cover the prices the pipelines had agreed to pay in their take-or-pay contracts. As a result, by 1987, the pipelines faced billions of dollars of accrued take-or-pay liability and future take-or-pay exposure. See *Mobil Oil Exploration & Producing Southeast, Inc.* v. *United Distribution Cos.*, 111 S. Ct. 615, 627 (1991).[2]

3. *The Commission's Response to the Take-or-Pay Problem*

In 1987, the D.C. Circuit rejected a variety of challenges to FERC's Order No. 436, but held that the Commission had failed adequately to address the effects of the open-access policy on the pipelines' take-or-pay exposure. See *Associated Gas Distributors* v. *FERC*, 824 F.2d 981, 996, 1021-1030 (1987), cert. denied, 485 U.S. 1006 (1988). On remand, the Commission issued a series of orders, beginning with Order No. 500,[3] that retained

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[2] See also Order No. 500-H, *Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol,* 54 Fed. Reg. 52,344, 52,348, 52,356 (1989).

[3] Order No. 500, *Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol,* 52 Fed. Reg. 30,334 (1987). Order No.

Order No. 436's open-access provisions but also instituted a policy of "equitable sharing" of take-or-pay liability across the natural-gas industry. With those orders, the Commission sought to encourage both producers and pipelines to absorb a portion of the unresolved take-or-pay liability and to provide for a fair allocation of the remaining liability among the pipelines' customers.

a. Order No. 500 encouraged producers and pipelines to enter into settlements under which the pipelines would "buy down" their existing take-or-pay contracts by reforming their provisions and "buy out" their accrued liability under those contracts. In those settlements, pipelines obligated themselves to pay substantial sums to producers.[4]

b. Order No. 500 also encouraged pipelines to absorb a portion of the buy-out and buy-down costs they incurred, rather than passing them on to their customers. Under traditional FERC ratemaking procedures, a pipeline would generally be entitled to recover prudently incurred costs by means of a surcharge on rates charged on current gas sales. Order No. 500 preserved that option, but many pipelines maintained that its usefulness was limited under prevailing market conditions. Because

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500 was an interim order; it was supplemented by a series of additional orders, Order Nos. 500-A to 500-I. The final rule regarding the resolution of take-or-pay exposure was Order No. 500-H, *Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, 54 Fed. Reg. 52,344 (1989), aff'd on reh'g, Order No. 500-I, *Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, 55 Fed. Reg. 6605 (1990). These orders, in turn, have been the subject of a series of decisions by the D.C. Circuit. *American Gas Ass'n* v. *FERC*, 888 F.2d 136 (1989); *Associated Gas Distributors* v. *FERC*, 893 F.2d 349, 355 (1989); cert. denied, 111 S. Ct. 277 (1990); *Transwestern Pipeline Co.* v. *FERC*, 897 F.2d 570 (1990); *American Gas Ass'n* v. *FERC*, 912 F.2d 1496 (1990), cert. denied, 111 S. Ct. 957 (1991). For ease of reference, we will refer to this series of orders as "Order No. 500," except where a more specific reference is appropriate.

[4] Order No. 500, 52 Fed. Reg. at 30,338-30,341; Order No. 500-H, 54 Fed. Reg. at 52,358-52,387.

of increased competition for gas sales, if a pipeline set its rates high enough to cover its take-or-pay settlement costs, it would run the risk of being unable to locate buyers at those rates.[5]

Recognizing those economic considerations, Order No. 500 provided pipelines an alternative that virtually all pipelines chose to use. If a pipeline agreed to absorb—not pass through—between 25% and 50% of its take-or-pay costs, Order No. 500 authorized it to recover an equal amount by means of a direct, fixed charge to its past sales customers, rather than an additional charge on current sales of gas.[6] Such a fixed charge, unlike a surcharge, would not increase the current price of the pipeline's natural gas. Thus, its effectiveness as a means of recovering take-or-pay settlement costs would not depend on locating a willing buyer at an increased price.[7]

c. In exercising its authority to approve tariffs providing for recovery of fixed take-or-pay charges, FERC was called upon to determine how much of those charges each customer of a pipeline would be required to pay. Initially, FERC employed the "purchase deficiency" method for that purpose. Under this approach, the pipeline compared each customer's cumulative gas purchases in a period after the open-access policy had taken effect (the so-called "deficiency period") with its purchases during a representative period before that policy had been implemented (the "base period"). The pipeline then allocated the direct-billed portion of its take-or-pay costs to each customer in proportion to the decline in that customer's purchases during the deficiency period. Under this system, pipeline customers who reduced their purchases from the pipeline to buy less costly gas at the wellhead would bear a greater share of the cost of resolving the pipeline's take-or-pay liability than would customers whose purchase levels remained relatively constant.[8]

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[5] Order No. 500, 52 Fed. Reg. at 30,341-30,346; Order No. 500-H, 54 Fed. Reg. at 52,387.

[6] Order No. 500, 52 Fed. Reg. at 30,341. The pipeline could also seek to recover the remaining percentage of its take-or-pay liability, if any, by means of a volumetric surcharge on both sales and transportation of gas. *Ibid.*

[7] Order No. 500-H, 54 Fed. Reg. at 52,387.

In *Associated Gas Distributors* v. *FERC*, 893 F.2d at 355, the D.C. Circuit struck down the purchase deficiency method. The court reasoned that the use of that method was tantamount to a retroactive rate increase for previous sales of gas and was thus a violation of the filed rate doctrine. This Court denied certiorari. 111 S. Ct. 277 (1990). FERC then issued Order No. 528, which stayed the effectiveness of tariffs employing the purchase deficiency method (except where a FERC order approving such an allocation had become final and nonappealable).[9] Order No. 528 did not prescribe any particular substitute for the purchase deficiency method. Rather, it set forth broad principles by which FERC would assess allocation methods proposed by particular pipelines, described several acceptable alternatives, and encouraged pipelines and their customers to negotiate arrangements to replace the purchase deficiency method.

d. The Natural Gas Act preserves state authority over "local distribution of natural gas," 15 U.S.C. 717(b). Consequently, Order No. 500 did not attempt "to prescribe the methods by which approved pipeline take-or-pay costs are to be allocated at the state level"—*i.e.*, the extent to which LDCs could pass on take-or-pay charges to their customers.[10] The Commission did, however, express

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[8] Order No. 500, 52 Fed. Reg. at 30,351-30,352; Order No. 500-I, 55 Fed. Reg. at 6621.

[9] Order No. 528, *Mechanisms for Passthrough of Pipeline Take-or-Pay Buyout and Buydown Costs*, 55 Fed. Reg. 47,863 (1990), reh'g granted in part and denied in part, Order No. 528-A, 54 F.E.R.C. ¶ 61,095 (1991), reh'g denied, Order No. 528-B, 55 F.E.R.C. ¶ 61,372 (1991), appeal pending *sub nom. Tennessee Gas Pipeline Co.* v. *FERC*, No. 91-1069 (D.C. Cir. filed Feb. 8, 1991).

[10] Order No. 500, 52 Fed. Reg. at 30,344.

the view that "there should be an equitable sharing of take-or-pay costs among all segments of the industry," and that state regulatory agencies are not preempted by federal law "from designing LDC rates, or, in appropriate circumstances, from reviewing the prudence of LDCs' purchasing decisions insofar as they affect take-or-pay costs."[11]

4. *Proceedings in This Case*

a. In April 1988, the Illinois Commerce Commission began an investigation into the "appropriate recovery by Illinois gas utilities of costs associated with take-or-pay charges from interstate pipeline companies." Pet. App. A74. Throughout the Illinois Commission's proceeding, the direct charges made by interstate pipelines were computed pursuant to the "purchase deficiency" method; the D.C. Circuit's decision in *Associated Gas Distributors* disapproving that methodology was not issued until after the Commission entered its final order. Illinois LDCs and representatives of Illinois residential and industrial energy consumers, including petitioner Office of Public Counsel, were parties to these proceedings before the Illinois Commission.

In an interim order, the Illinois Commission addressed the question whether it was "required, as a matter of law, to allow gas utilities subject to its jurisdiction to recover pipeline take-or-pay costs billed under the so-called direct-billing mechanism authorized by FERC Order No. 500." Pet. App. A76; see *id.* at A73-A89. The Commission concluded that this Court's decision in *Mississippi Power & Light Co.* v. *Mississippi*, 487 U.S. 354 (1988), "precludes state regulatory agencies from disallowing recovery of direct billed FERC-allocated past take-or-pay costs in retail rates, and precludes such agencies from conducting prudence reviews relating to such costs." Pet. App. A84.[12] The Commission reaffirmed that determination in its final order. *Id.* at A97, A121-A122.

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[11] Order No. 500, 52 Fed. Reg. at 30,344 (quoted at Pet. App. A54-A55). Accord Order No. 500-H, 54 Fed. Reg. at 52,387-52,388; Order No. 500-I, 55 Fed. Reg. at 6622-6623. The Commission expressed a similar view in Order No. 528, 55 Fed. Reg. at 47,865.

A prudence review is a customary aspect of utility ratemaking. When a regulated utility seeks to include costs incurred in supplying natural gas (or electricity) to be recovered from its customers, its regulator may generally consider whether those costs have been prudently incurred. If the regulator concludes that the costs were the result of imprudence, it may disallow them, effectively reducing the rate of return realized by the utility's shareholders. See, *e.g.*, *Mississippi Power & Light Co.* v. *Mississippi*, 487 U.S. 354, 366-368 (1988).

b. By a 2-1 vote, the Illinois Appellate Court for the Fourth District reversed. Pet. App. A33-A72. The court noted that state laws and administrative regulations may be preempted in any of three ways: (1) when the language of a federal statute "specifically preempts State regulation of the subject matter"; (2) when Congress or a federal agency has "indicate[d] an intention to occupy the entire field of regulation"; or (3) when compliance with both state and federal law is impossible or state regulation poses an obstacle to accomplishment of the purpose of federal regulation. *Id.* at A51. Applying those principles to this case, the court first determined that "the congressional intent in enacting the Natural Gas Act was to generally leave to State regulatory agencies the regulation of the rates of LDC's." *Id.* at A54. Second, the court found that FERC's Order No. 500 "manifested an intention *not* to preempt State regulatory agency decisions which might require LDC's to share with rate payers (*i.e.*, absorb) a portion of their take-or-pay costs," adding that "FERC's interpretation of its authority * * * is entitled to deference." *Id.* at A56. Third, the court concluded that it would be possible for LDCs to comply

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[12] In *Mississippi Power*, this Court held that a state regulatory commission could not disallow amounts that members of an interstate public utility holding company system were required to pay for power produced by a nuclear power plant, when FERC orders obligated each member of the system to purchase specified shares of that power at specified rates. See pp. 13-15, *infra*.

"with both FERC regulations governing take-or-pay costs and a State administrative agency regulation or decision requiring LDC's to absorb some of their take-or-pay costs," and that such a state decision would not "frustrate a purpose or goal of Congress [or] FERC." *Id.* at A57.

The Illinois Appellate Court rejected the LDCs' contention that this Court's decisions in *Mississippi Power* and *Nantahala Power & Light Co.* v. *Thornburg*, 476 U.S. 953 (1986), necessarily entitled the LDCs to pass on all of their fixed take-or-pay charges. In those cases, the court explained, "there was a readily apparent intention on the part of FERC to preempt the entire field of allocation of power produced by interstate electricity pools," whereas here "FERC manifested an intention not to preempt action by the State regulatory agencies requiring LDC's to absorb portions of their take-or-pay costs." Pet. App. A58-A59.

"[T]he fact that LDC's have no present choice but to pay the take-or-pay costs billed to them," the Illinois Appellate Court continued, "does not necessarily mean they should be permitted full recovery of these costs." Pet. App. A62-A63. The court posited a situation in which an LDC's "[p]ast actions"—such as its "choice of a natural gas supplier which subsequently incurred high take-or-pay charges"—might have "influenced the amount of these costs," and it reserved the question whether such an LDC "should be denied full recovery of its take-or-pay costs, because of lack of prudence at the time that choice was made." *Id.* at A63. The court left open for the Illinois Commerce Commission to decide whether its prior annual reviews of the prudence of utilities' fuel purchases would preclude the Commission, as a matter of state law, from even conducting later prudence reviews of the same purchases. *Id.* at A63-A64. The court therefore ordered the case remanded to the Illinois Commerce Commission, directing the Commission to admit evidence pertaining to "(a) the sharing of the take-or-pay costs of LDC's between the LDC's and rate payers and (b) the factors relevant to the prudence of past purchasing practices of the LDC's as they relate to take-or-pay costs." *Id.* at A64.

c. The Illinois Supreme Court reversed and reinstated the Illinois Commission's order. Pet. App. A1-A32. Relying on this Court's decisions in *Nantahala* and *Mississippi Power*, the court held that "fundamental principles of Federal preemption, as reflected in the * * * filed rate doctrine, prohibit the [state commission] from conducting prudence reviews of FERC-mandated take-or-pay costs" and, accordingly, that Illinois LDCs "must be allowed to pass through to their customers the full amount of these charges." *Id.* at A32; see *id.* at A14-A19. The court rejected the contention, advanced by petitioner and others, that FERC's views favoring the equitable allocation of take-or-pay costs and recognizing the authority of state commissions to review the prudence of incurring take-or-pay costs were dispositive. *Id.* at A19-A26. Regardless of FERC's position, the court reasoned, "the intent of Congress is clear and controlling: 'States may not bar regulated utilities from passing through to retail consumers FERC-mandated wholesale rates.'" *Id.* at A25-A26 (quoting *Mississippi Power*, 487 U.S. at 372).

The court found that *Mississippi Power* and *Nantahala* foreclose any state review of the prudence of past actions by LDCs that subsequently caused them to be allocated take-or-pay costs through direct charges, computed under the purchase deficiency method. Pet. App. A26-A32. The court recognized that "States retain the authority to review the prudence of a distributor's actions in incurring FERC-approved supply charges when the distributor had a choice whether to incur the charge." *Id.* at A27; see p. 13, *infra.* But it concluded that "the distributors in this case cannot avoid the current take-or-pay charges," based on their past purchases, since FERC had approved those charges. Pet. App. A27-A28. The court also observed that "even if in this case the filed rate doctrine permitted State review of [LDCs'] past purchasing decisions it would be difficult to say in what respect [LDCs] have been imprudent in incurring these particular costs," since the LDCs "did not know and could not have foreseen at that time that those purchasing decisions would lead to the imposition of direct-billed take-or-pay costs years later." *Id.* at A30. The court accordingly declined to address the question whether "a prudence review under these circumstances would be inconsistent with Illinois law." *Id.* at A32.

DISCUSSION

In our view, the Illinois Supreme Court misapplied the filed rate doctrine to the particular circumstances of this case, which arose out of efforts to resolve the take-or-pay problem that confronted the natural gas industry in the 1980s. We nevertheless believe that this case does not warrant further review. To our knowledge, there is no conflict among state appellate courts on the question whether the filed rate doctrine allows state regulatory commissions to prevent LDCs from passing through a portion of the take-or-pay costs they incur under FERC's orders. Because the Illinois Supreme Court expressed serious doubt as to whether disallowance of any portion of those costs would be permitted even as a matter of state law, it is unclear that an order reversing that court's ruling regarding federal law would have any effect on the ultimate outcome of the case. Finally, the sums in question here—direct charges for take-or-pay settlement costs billed by pipelines to their customers—were computed in accordance with the "purchase deficiency" method. The D.C. Circuit has struck down that method, and the Illinois court's reasoning is confined to charges based upon that method.

1. a. As noted above, FERC possesses exclusive regulatory jurisdiction over "the transportation of natural

gas in interstate commerce" and "the sale in interstate commerce of natural gas for resale." 15 U.S.C. 717(b). With respect to rates, a natural-gas company must file "schedules showing all rates and charges for any transportation or sale subject to the jurisdiction of the Commission, and the classifications, practices, and regulations affecting such rates and charges, together with all contracts which in any manner affect or relate to such rates, classifications, and services." 15 U.S.C. 717c(c). FERC has authority to determine whether the terms set forth in any such filing are "unjust, unreasonable, unduly discriminatory, or preferential," and in the event it makes such a finding, to substitute just and reasonable terms. 15 U.S.C. 717d(a); see also 15 U.S.C. 717c.

FERC's exclusive authority over the rates charged in interstate wholesale sales of natural gas has several consequences, which together have come to be known as the "filed rate doctrine." First, the parties to a transaction within FERC's jurisdiction are bound by the rate filed with or fixed by FERC. Second, that rate is binding on the courts. As this Court made clear in *Montana-Dakota Utilities Co.* v. *Northwestern Public Serv. Co.*, 341 U.S. 246, 251-252 (1951), "the right to a reasonable rate is the right to the rate which the Commission files or fixes, and * * * except for review of the Commission's orders, the courts can assume no right to a different one on the ground that, in its opinion, it is the only or the more reasonable one." See *Arkansas Louisiana Gas Co.* v. *Hall*, 453 U.S. 571, 576-579 (1981) (*Arkla*).[13] Third, FERC itself "has no power to alter a [filed] rate retroactively." *Arkla*, 453 U.S. at 578. Finally, under certain conditions, state ratemakers are required to allow interstate wholesale purchasers to recover, through the rates charged in state-regulated retail sales, amounts the purchasers pay pursuant to FERC-mandated rates. *Mississippi Power, supra; Nantahala, supra.*

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[13] The Court noted in *Arkla*, 453 U.S. at 577 n.7, that the Natural Gas Act and the Federal Power Act, 16 U.S.C. 791a *et seq.*, draw substantially the same line between state and federal authority.

b. This case involves the last prong of the filed rate doctrine. In the context of an ordinary arms-length purchase of electricity or gas in interstate commerce, FERC will consider, in the course of determining whether the price charged by the seller to its customers is just and reasonable, whether costs incurred by the seller (and included in the rate) were prudently incurred. FERC does not, however, review the prudence of the purchase from the buyer's (LDC's) perspective. It is established that the State's jurisdiction over rates charged in retail sales—here, between LDCs and their customers—encompasses the questions whether it was prudent for the buyer to purchase at the FERC-mandated rate and, if not, how much of the purchase price should be disallowed from the retail rates charged by the buyer. See *Kentucky West Virginia Gas Co.* v. *Pennsylvania Public Utility Comm'n*, 837 F.2d 600 (3d Cir.), cert. denied, 488 U.S. 941 (1988); *Pike County Light & Power Co.* v. *Pennsylvania Public Utility Comm'n*, 465 A.2d 735 (Pa. Commw. 1983); *Narragansett Electric Co.* v. *FERC*, 381 A.2d 1358 (R.I. 1977), cert. denied, 435 U.S. 972 (1978).[14]

FERC's exclusive jurisdiction over interstate sales for resale has different implications, however, in the case of sales of electricity among members of interstate power pools. Such pools are characterized by systemwide planning, and members of the pool are simultaneously buyers and sellers of its power. In that situation, in the exercise of its jurisdiction over interstate transactions, FERC has allocated various sources of power, some more expensive than others, among members of the pool. With respect to the power pools at issue in *Nantahala* and *Mississippi Power*, FERC entered orders that (1) allocated specified shares of high-cost or low-cost power to members of the pools in question, and (2) fixed the rates for such power. The effect of the orders was to require members of each pool to purchase specified quantities of power from the pool at the FERC-mandated rates.

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[14] See *Nantahala*, 476 U.S. at 972; *Mississippi Power*, 487 U.S. 373-374.

In cases such as *Nantahala* and *Mississippi Power*, a FERC order allocating the pool's power and fixing the applicable rates leaves no room for a state determination of the prudence of a pool member in its purchase of power.[15] FERC's order requires the purchaser to buy a specified quantity of power at a price FERC has determined to be just and reasonable. A State's refusal to allow the buyer to recover the amount it is thereby required to pay—on the basis of a determination that the buyer was imprudent in making the purchase—would impermissibly infringe upon FERC's exercise of its exclusive jurisdiction over interstate transactions among members of the pool.

That was the holding of *Mississippi Power* and *Nantahala*. As the Court stated in the former case, "the Supremacy Clause compels [state ratemakers] to permit [the power pool member] to recover as reasonable operating expense costs incurred as the result of paying *a FERC-determined wholesale rate for a FERC-mandated allocation of power*." 487 U.S. at 373 (emphasis added). State ratemakers "may not enter an order 'trapping' the costs [the pool member] is mandated to pay under the FERC order allocating [the pool's] power or undertake a 'prudence' review for the purpose of deciding whether to enter such an order." *Id.* at 372. The Court stressed that a State's determination that it was imprudent for the pool member to take and pay for power in accordance with FERC's orders interfered with FERC's exclusive jurisdiction: "if the integrity of FERC regulation is to be preserved, it obviously cannot be unreasonable for the [pool member] to procure the particular quantity of high-priced * * * power that FERC has ordered it to pay for." *Id.* at 374.

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[15] That is so whether or not the issue of prudence was actually raised before FERC. *Mississippi Power*, 487 U.S. at 375. See *id.* at 379 (Scalia, J., concurring in the judgment); *Northwest Central Pipeline Corp.* v. *Kansas Corp. Comm'n*, 489 U.S. 493, 509 (1989); *Schneidewind* v. *ANR Pipeline Co.*, 485 U.S. 293, 300 (1988); *FPC* v. *Southern California Edison Co.*, 376 U.S. 205, 215-216 (1964).

c. In our view, the Illinois Supreme Court mistakenly extended the rule of *Nantahala* and *Mississippi Power* to a situation in which the preconditions for its operation were not present (and in which FERC did not otherwise express an intent to preempt the challenged action by a state commission). *Mississippi Power* and *Nantahala* prohibit state regulators from finding that actions FERC required a buyer at wholesale to take were imprudent. Those holdings apply only when FERC requires the buyer to purchase a specified amount of gas or electric power at a FERC-mandated rate. Here, petitioner proposed to show that Illinois LDCs made past purchasing decisions, not required by FERC, that had increased the LDCs' subsequent liability for take-or-pay costs under the purchase deficiency method. See Pet. Ill. S. Ct. Br. 27-28. The rationale of *Nantahala* and *Mississippi Power* does not foreclose such an inquiry by a state commission.

Moreover, the Illinois Supreme Court was mistaken in its suggestion that FERC has attempted to specify the preemptive effect of its orders under the filed rate doctrine. When FERC stated in Order No. 500 that the filed rate doctrine did not preclude state regulators "from designing LDC rates, or, in appropriate circumstances, from reviewing the prudence of LDCs' purchasing decisions insofar as they affect take-or-pay costs," 52 Fed. Reg. at 30,344, FERC was not suggesting that it had the power to authorize state inquiries and determinations that would otherwise be preempted by the Natural Gas Act itself. Rather, FERC's position was that such inquiries and determinations did not, unlike the prudence review at issue in *Mississippi Power*, infringe on its statutorily mandated exclusive jurisdiction over interstate transactions. FERC's interpretation of its statutory jurisdiction was entitled to more deference than it received from the Illinois Supreme Court.[16]

2. Although we believe that the Illinois Supreme Court erred in its application of the filed rate doctrine here, three factors independently suggest that further review is not warranted in this case.

First, to our knowledge, no other state supreme court has yet addressed the issue, and there is no conflict among state appellate courts at any level with respect to the application of the filed rate doctrine to take-or-pay costs imposed on LDCs. In *Association of Businesses Advocating Tariff Equity (ABATE)* v. *Michigan Public Serv. Comm'n*, No. 129564 (Nov. 18, 1991), the Michigan Court of Appeals agreed with the Illinois Supreme Court in this case that the filed rate doctrine entitled LDCs in Michigan to pass on their take-or-pay costs.[17] In *General Motors Corp.* v. *Public Service Comm'n*, 589 A.2d 982 (1991), the Maryland Court of Special Appeals reserved the federal preemption question, while holding that state law did not authorize disallowance of any of the take-or-pay costs from the rates charged by LDCs to their customers.[18] We are unaware of any other appellate decisions addressing the question presented by this case.[19]

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[16] This case does not present any question concerning FERC's authority, by administrative action, to give broader preemptive effect to its orders than the Act itself (including the filed rate doctrine it embodies) requires. Compare *Fidelity Federal Savings & Loan Ass'n* v. *de la Cuesta*, 458 U.S. 141, 153-154 (1982).

[17] We have been informed by the Michigan Attorney General's Office that a request for leave to pursue a discretionary appeal from this decision to the Michigan Supreme Court is presently pending before that court.

[18] The Maryland People's Counsel informed FERC that no appeals were taken from that ruling and that the take-or-pay issue was subsequently settled before the state commission.

[19] A state trial court in South Carolina has held that the filed rate doctrine does not foreclose a state prudence review of actions rele-

Second, the decisions of the Illinois Commerce Commission and the Illinois courts indicate that petitioner has sought to raise alleged imprudence by the LDCs as the basis for requiring them to absorb a portion of the take-or-pay charges. Although it stopped short of holding that state law precludes such a showing, the Illinois Supreme Court expressed serious doubt that a prudence claim could be sustained, stating: "even if in this case the filed rate doctrine permitted State review of distribu-

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vant to take-or-pay charges. *Hamm* v. *South Carolina Pub. Serv. Comm'n*, No. 89-CP-40-0625 (Ct. Comm. Pl., Richland County June 10, 1991). This decision relied heavily on the reasoning of the intermediate appellate decision in the instant case; it did not refer to the Illinois Supreme Court's decision, which had been issued less than a week earlier. The trial court's ruling in *Hamm* is now pending on appeal to the South Carolina Supreme Court. *Hamm* v. *South Carolina Pub. Serv. Comm'n*, No. 91-797 (argued Feb. 3, 1992). A decision of the New Hampshire Public Utilities Commission that adopted an "equitable sharing" approach requiring two LDCs to absorb 40% of their take-or-pay costs, over their objection that such an order was preempted by the filed rate doctrine (*In re Energy-North Natural Gas, Inc.*, 122 P.U.R.4th 449 (June 3, 1991), reh'g denied, 124 P.U.R.4th 160 (July 1, 1991)), is currently pending on review in the New Hampshire Supreme Court. If a substantial conflict among the decisions of state courts of last resort should develop in the future, there will be time enough for this Court to consider whether the issues presented warrant review.

A survey by FERC in 1991 found that commissions in 21 States were allowing LDCs to pass through 100% of the take-or-pay costs billed to them, while six had required LDCs to absorb some of those costs. Decisions by state ratemaking bodies illustrating some of the approaches adopted include: *In re Northern Indiana Public Serv. Co.*, 97 P.U.R.4th 1, 4-7 (Ind. U.R.C. 1988) (authorizing full pass-through of take-or-pay costs); *In re Planning Review, Rate Design, Purchased Gas Adjustment Clauses, Accounting, and Related Matters for Natural Gas Distribution Utilities*, 99 P.U.R.4th 253 (Wisc. P.S.C. 1989) (holding that while federal preemption does not preclude a prudence review, such a review would serve little purpose under the circumstances present in Wisconsin); *In re Southern California Gas Co.*, 109 P.U.R.4th 1, 31-34 (Cal. P.U.C. 1990) (providing for equitable sharing of take-or-pay costs); *In re Delmarva Power & Light Co.*, 116 P.U.R.4th 287 (Del. P.S.C. 1990) (authorizing pass-through of take-or-pay costs).

tors' past purchasing decisions, it would be difficult to say in what respect distributors have been imprudent in incurring these particular costs." Pet. App. A30. The court added that "unless clairvoyance has become an element of prudence, there simply is no basis on which the [Illinois Commerce Commission] could conduct a meaningful prudence review." *Id.* at A31. The nature of the actions that might warrant holding an LDC responsible for a portion of direct take-or-pay charges is an issue of state law. Thus, there is serious reason to question whether a ruling by this Court reversing the Illinois Supreme Court's decision and remanding for consideration of the issues identified by the intermediate appellate court (Pet. App. A64) would have any effect on the ultimate outcome of this case.

Third, the take-or-pay charges that were the subject of the Illinois Commerce Commission's proceeding, and thus of the Illinois Supreme Court's decision, were fixed, direct charges computed in accordance with the "purchase deficiency" method. See Pet. App. A88 (Illinois Commerce Commission's order addressing "direct billed past take-or-pay costs"). As we have noted, the D.C. Circuit held in *Associated Gas Distributors* v. *FERC*, 893 F.2d at 355, that use of the purchase deficiency method violates the filed rate doctrine. As a result of the D.C. Circuit's decision, FERC issued its Order No. 528, which stayed the effectiveness of most pipeline tariffs that incorporated the purchase deficiency method. The only tariffs excluded from that stay were those, including settlements, that FERC had approved in orders that became final and nonappealable prior to the issuance of the D.C. Circuit's mandate. Although none of the decisions below addresses the point, it appears that the D.C. Circuit's opinion will affect most, if not all, of the direct-billed charges at issue in this case, and therefore will require that take-or-pay charges be passed on by interstate pipelines to Illinois LDCs by some other method.

Order No. 528 does not prescribe any single methodology to replace the purchase deficiency method. Rather, it gives interstate pipelines and their customers flexibility to design cost-allocation mechanisms. Order No. 528 lists several examples of "acceptable allocation methods" by which pipelines may seek to recover costs that previously could have been recovered by means of a fixed charge computed pursuant to the purchase deficiency method. These include fixed charges based upon some current measure of demand or usage (such as contract demand, peak demand, or actual throughput); volumetric surcharges; some combination of fixed charges and volumetric surcharges; or any agreed-upon methodology consistent with FERC's general principles.[20]

The Illinois Supreme Court's reasoning with respect to the filed rate doctrine is limited to direct charges computed using the purchase deficiency method. In the court's view, *Nantahala* and *Mississippi Power* were controlling here because the take-or-pay charges imposed on the LDCs were based upon the LDCs' past purchasing decisions and thus could not have been avoided. See Pet. App. A26-A30. In its brief in opposition in this Court (at 11-12), the Illinois Commerce Commission represents that its "preemption analysis," which was affirmed by the Illinois Supreme Court, "was confined * * * to recovery of direct-billed, FERC-allocated costs." Similarly, the legal analysis in another of the briefs in opposition emphasizes that the charges in question were computed on the basis of past sales, acknowledging that a different analysis might be appropriate for take-or-pay charges that are included (as Order No. 528 allows) in the costs of *current* gas purchases, which could be avoided by an Illinois LDC that was able to purchase cheaper gas elsewhere. Northern Illinois Gas Co. Br. in Opp. 12-13, 16-17.[21]

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[20] Order No. 528, 55 Fed. Reg. at 47,865-47,867. The four principles FERC adopted in Order No. 528 are that (1) the costs should be spread as broadly as possible so that "all segments of the industry—pipelines, producers, LDC's, industrial end-users, and other consumers—should contribute to funding the pipelines' take-or-pay costs"; (2) pipelines should absorb a significant proportion of the costs; (3) "captive sales customers—namely residential and small commercial gas users—should not bear a disproportionate share of take-or-pay costs"; and (4) pipelines and producers should abide by existing settlement agreements. *Id.* at 47,865-47,866.

For present purposes, the D.C. Circuit's decision in *Associated Gas Distributors* invalidating the purchase deficiency method has two significant consequences. First, it is unclear to what extent there remains a live controversy over the application of the filed rate doctrine to direct-billed charges computed in accordance with that method, either in Illinois or elsewhere. Second, a decision by this Court addressing that issue would have limited prospective significance, because FERC Order No. 528 now requires new methods for allocating past take-or-pay costs (except where a FERC order approving an allocation based on the purchase deficiency method had already become final). Moreover, any ruling by this Court concerning the scope of the filed rate doctrine in this case might be of limited precedential significance outside the unique context of the allocation of past take-or-pay costs through fixed charges. For these reasons, and in the absence of any conflict among state supreme courts, it is our view that this issue does not now warrant this Court's review.

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[21] In the Illinois Supreme Court, certain respondents argued that the D.C. Circuit's decision in *Associated Gas Distributors* would not affect the unavoidability of the take-or-pay charges that might be computed under methods supplanting the purchase deficiency method. Peoples Gas Light & Coke Co. Ill. S. Ct. Br. 11 n.4.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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